

No. 11071

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United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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DAISY MAY HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of the Record

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Upon Petition to Review a Decision of the Tax Court  
of the United States

FILED

SEP 14 1945

PAUL P. O'BRIEN,  
CLERK



No. 11071

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Circuit Court of Appeals  
For the Ninth Circuit.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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## APPEARANCES:

For Taxpayer:

BYRON C. HANNA, Esq.,  
A. CALDER MACKAY, Esq.  
ADAM Y. BENNION, Esq.

For Comm'r:

EARL C. CROUTER, Esq.

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Docket No. 740

DAISY MAY HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## DOCKET ENTRIES

1943

- Feb. 10—Petition received and filed. Taxpayer notified. Fee paid.
- Feb. 11—Copy of petition served on General Counsel.
- Apr. 8—Answer filed by General Counsel.
- Apr. 8—Request for hearing in Los Angeles, California, filed by General Counsel.
- Apr. 14—Notice issued placing proceeding on Los Angeles, California calendar. Service of answer and request made.

1944

- Feb. 29—Hearing set April 24, 1944 in Los Angeles, California.
- Apr. 27, 28—Hearing had before Judge Hill on merits. Motion of counsel for petitioner to consolidate the cases and there being no objection by counsel for respondent. Ordered that the cases be consolidated, 739 & 740. Entry of appearance of A. Calder MacKay Esq., and A. Y. Bennion, Esq., filed at hearing. Briefs due 6/13/44. Replies due 6/28/44. (Simultaneous)
- Jun. 1—Motion for extension to July 1 and July 22, 1944 respectively, to file original and reply brief filed by General Counsel. 6/2/44 Granted.
- Jun. 12—Motion for extension to July 1 and July 22, 1944 respectively, to file original and reply brief filed by taxpayer. 6/13/44 Granted.
- Jun. 19—Transcript of hearing 4/27, 28/44 filed.
- Jun. 23—Motion for extension to July 18, 1944 to file brief filed by taxpayer. 6/26/44 Granted.
- Jul. 1—Brief filed by General Counsel. Served 8/2/44.
- Jul. 12—Motion for extension to Aug. 3, 1944 to file original brief and to Aug. 24, 1944, respectively, to file reply brief, filed by taxpayer. 7/13/44 Granted.

**1944**

Aug. 2—Brief filed by taxpayer. 8/2/44 Copy served.

Aug. 17—Reply brief filed by General Counsel.

Aug. 24—Reply brief filed by taxpayer. Copy served.

**1945**

Jan. 15—Memorandum findings of fact and opinion rendered. Judge Hill. Decision will be entered for respondent. Copies served.

Jan. 15—Decision entered. Judge Hill. Div. 2.

**[1\*]**

Apr. 12—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Apr. 13—Proof of service filed by taxpayer.

May 19—Agreed statement of evidence filed.

May 19—Statement of points to be relied on and designation of parts of the record to be printed filed by taxpayer with proof of service thereon.

May 19—Designation of contents of record filed by taxpayer with proof of service thereon.

May 23—Certified copy of order from U. S. Circuit Court of Appeals, 9th Circuit, extending time to 6/22/45 to prepare and deliver the record. **[2]**

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\*Page numbering appearing at top of page of original certified Transcript of Record.

## The Tax Court of the United States

Docket No. 740

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

## PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency LA:IT:90D:PB, dated November 17, 1942; and as a basis of her proceeding alleges as follows:

(1) The petitioner is an individual whose office is located at 1126 Pacific Mutual Building, Los Angeles, California. The return for the period here involved was filed with the Collector for the Sixth District of California.

(2) The Notice of Deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on November 17, 1942.

(3) The taxes in controversy are income taxes for the calendar year 1940, in the amount of \$3,476.26. Notice of deficiency discloses a deficiency of \$3,484.95, [3] which includes a deficiency for the calendar year 1939 in the amount of \$8.69, concerning which no question is raised.

(4) The determination of taxes set forth in

the said Notice of Deficiency for the calendar year 1940 is based on the following errors:

(a) The addition and inclusion in petitioner's income for said calendar year of 1940 of the amount of \$28,821.93 as petitioner's share of the community income of petitioner's husband and herself derived from the partnership of Hanna and Morton hereinafter referred to.

(b) The rejection of the application of section 107 of the Internal Revenue Code to a fee received by the partnership of Hanna and Morton in 1940, earned by services extending over a period of eight years.

(5) The facts upon which petitioner relies as the basis of this proceeding are as follows:

A. That at all times herein mentioned:

(a) Byron C. Hanna and petitioner were husband and wife and residents of the State of California. [4]

(b) Byron C. Hanna and Harold C. Morton were equal partners engaged in the practice of law in the City of Los Angeles, State of California under the firm name and style of Hanna and Morton.

B. In July, 1932, Mr. Etienne Lang, representing the Lazard Family, consulted Harold C. Morton, partner of the said Byron C. Hanna, with reference to an important action to be brought on behalf of the members of the Lazard Family.

Thereafter, on August 14, 1932, Mr. Lang paid the firm of Hanna and Morton, of which said Byron C. Hanna is a partner, \$2500.00 for preliminary work, which included the drafting of a complaint

to be submitted to the examination of French counsel.

At that point the service for which the \$2500.00 was paid was complete. There was no obligation on the part of Hanna and Morton to render any further service or to proceed with any action, and no obligation on the part of the clients to employ said firm any further.

C. Thereafter, in October, 1932, Mr. Lang negotiated with Mr. Morton for the employment of Hanna and Morton to conduct said contemplated litigation.

Four different bases of compensation were suggested by Mr. Lang, and the basis of compensation set [5] forth in the contract, a copy of which is annexed hereto and marked "Exhibit B" was selected and accepted by Hanna and Morton.

The contract provides for the immediate payment of \$30,000. The actual amount to be paid was \$27,500. The figure of \$30,000 was inserted at the suggestion of Mr. Lang so as to include and evidence the payment of the \$2,500 previously paid; but said amount of \$2,500 at that time had been entirely earned and paid on August 14, 1932, and represented compensation for an employment separate and distinct from work to be done under the terms of the contract.

D. The sum of \$27,500 was paid to Hanna and Morton on October 15, 1932, upon the execution of the contract.

E. It was known to all parties at that time



(October 15, 1932) that there would be large and substantial costs incurred in connection with the litigation to be prosecuted; and under the terms of the contract, Hanna and Morton assumed the absolute and unconditional obligation to defray the expense of such costs.

By executing the contract and receiving the sum of \$27,500 they also assumed the fiduciary obligation to apply as much of the said sum of \$27,500 as might be required, or all of it if all were required, to the payment of such expenses and costs. [6]

F. At the time of the receipt of said sum of \$27,500 it was not contemplated by the parties that said sum or any part of it would constitute a fee or income to Hanna and Morton except and until all of the expense and costs of such litigation had been paid.

G. The fee for the professional services to be rendered in the litigation was contingent upon success and was to be determined by calculating a percentage of the recovery as set forth in the contract.

H. Consistent with the method of accounting used by Hanna and Morton, the cash payment of \$27,500 was treated in the books of said partnership as a trust fund against which the direct expenses and costs of the litigation was charged. There was also transferred from said trust fund to the partners or to the general account of the partnership the sum of \$5,500, as follows:

October 15, 1932 .....	\$2,000.00
October 31, 1932 .....	1,500.00
May 1, 1933 .....	1,000.00
October 31, 1936 .....	1,000.00
Total .....	\$5,500.00

These amounts were transferred to partially compensate the partnership for expenses in connection with said employment, including salaries of lawyers employed by the partnership, stenographic help, stationery, etc. incident [7] to the work of said employment and which expenses were paid out of the general funds of the partnership and not charged directly against said trust fund.

1. Consistent with the foregoing the petitioner, in each of the calendar years noted in the preceding paragraph, returned as income the amount received by her by reason of her community interest in the amount transferred to the General Account of the partnership during each such calendar year respectively, as hereinbefore set forth.

Aside from such amounts, petitioner did not include in her income tax returns for the calendar year 1932 or for any year subsequent thereto until 1940, any other portion of said sum of \$27,500, but at all times treated and regarded the said sum, excepting the portions thereof transferred to the General Account of the partnership, as aforesaid, as trust funds which did not constitute income to petitioner.

J. In 1941 petitioner filed an income tax return reporting as income petitioner's community share



in said fee upon the basis provided in section 107 of the Internal Revenue Code.

The Notice of Deficiency disallows this method of returning the said community income of petitioner resulting from said fee, and upon that basis adds to the community income of petitioner for the year 1940 the sum [8] of \$28,821.93 upon which the deficiency for said year is calculated.

It is the addition of this amount of income to petitioner for the calendar year 1940, and the rejection of the application of section 107 of the Internal Revenue Code, which petitioner alleges to be erroneous.

K. The litigation was successfully concluded in 1940, and the contingent fee collected. At that time the unexpended balance in the trust fund amounted to \$7,769.55. This was considered as income earned in that year and was transferred to the general funds of the partnership and added to the contingent fee.

L. The Notice of Deficiency is based upon the assumption that the cash payment of \$27,500 in 1932 was part of the total fee, and that as a result, an amount in excess of five per cent of the total fee was thus received.

The notice, however, ignores the fact that upon that theory the \$27,500 should have been returned as income in 1932, and would be assessable as income in 1932. This is a necessary consequence of the application of the theory upon which the Notice of Deficiency is based.

M. The undersigned alleges that the payment of \$27,500 received in 1932 was accepted subject to an unconditional obligation to pay and defray the expenses of said litigation in an indeterminable amount but nevertheless in [9] an amount which it was then known would be very substantial. No part of said \$27,500 could be treated as income or profit until the complete performance of the obligations of the contract, and therefore the portions thereof, if any, returnable as income, could only be determined at such time.

N. Petitioner alleges that petitioner's part of the income under this contract was received as follows:

1932 Payment .....	\$ 27,500.00	
Litigation Costs during period		
1932 and 1940 .....	\$ 14,230.45	
Portion taken into Partnership income		
in 1932, 1933 and 1936 .....	\$ 5,500.00	\$ 19,730.45
Determined by Events as Fee in 1940		\$ 7,769.55
Contingent Fee (1940) .....	\$114,018.19	
Paid to Other Lawyers .....	6,500.00	107,518.19
Total Fee—1940 .....		<u>\$115,287.74</u>

Petitioner further alleges that the application of section 107 of the Internal Revenue Code is permissible; and if said section is applied, there is no deficiency for the calendar year 1940.

O. Petitioner further alleges that if said section 107 of the Internal Revenue Code is not applicable, then the amount of \$27,500 should be assessed as

income received by the partnership in 1932 and deducted from the total income received by the partnership in 1940; and that the additional tax assessed to [10] Petitioner in the Notice of Deficiency should be accordingly reduced.

Whereupon, the Petitioner prays that this Honorable Court may hear the proceeding and:

(1) Determine that no deficiency exists for the calendar year 1940; or

(2) If it be determined that section 107 of the Internal Revenue Code is not applicable to the fee above referred to, then that the item of \$27,500 received in 1932 shall be treated as partnership income for that year; and that petitioner shall be assessed on her participation in said sum for that year, and that the amount so determined to have been received in 1932 shall be deducted from the amount of said fee charged to petitioner as having been received in 1940, and the deficiency reduced accordingly.

DAISY MAY HANNA

Petitioner.

BYRON C. HANNA

Attorney for Petitioner. [11]

## EXHIBIT A

Treasury Department  
Internal Revenue Service  
Twelfth Floor, U. S. Post Office and Courthouse  
Los Angeles, Calif.

Nov. 17, 1942

Office of  
Internal Revenue Agent in Charge  
Los Angeles Division  
LA:IT:90D:PB

Mrs. Daisy May Hanna,  
1126 Pacific Mutual Buiding,  
Los Angeles, California

Madam:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1939 and December 31, 1940 discloses a deficiency of \$3,484.95 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the The Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf.

The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By GEORGE D. MARTIN (Signed)

Internal Revenue Agent in

Charge.

Enclosures:

Statement.

Form of waiver. [12]

Statement

LA:IT:90D:PB

Mrs. Daisy May Hanna,

1126 Pacific Mutual Building,

Los Angeles, California.

Tax Liability for the Taxable Years Ended  
December 31, 1939 and 1940

Income Tax

Year	Liability	Assessed	Deficiency
1939	\$ 533.02	\$ 524.33	\$ 8.69
1940	8,582.74	5,106.48	3,476.26
Total	<hr/> \$9,115.76	<hr/> \$5,630.81	<hr/> \$3,484.95

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to

stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of the deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition The Tax Court of the United States for a redetermination of the deficiency.

A copy of this letter and statement has been mailed to your representative, Mr. Edgar P. Lyons, 639 South Spring Street, Los Angeles, California, in accordance with the authority contained in the power of attorney executed by you.

Adjustment To Net Income  
Taxable Year Ended December 31, 1939

Net income as disclosed by return .....	\$9,816.09
Additional income:	
Partnership income .....	90.56
	<hr/>
Net income adjusted .....	\$9,906.65
	[13]

Statement.

Explanation Of Adjustment

Your share of the net income from the partnership of Hanna and Morton has been increased in the amount of \$90.56.



Computation Of Tax  
Taxable Year Ended December 31, 1939

Net income adjusted .....	\$9,906.65	
Less: Personal exemption .....	\$780.15	
Credit for dependent .....	400.00	1,180.15
		<hr/>
Balance (surtax net income).....	\$8,726.50	
Less: Earned income credit (10% of \$9,906.65).....	990.67	
		<hr/>
Net income subject to normal tax.....	\$7,735.83	
Normal tax at 4% on \$7,735.83.....	\$309.43	
Surtax on \$8,726.50 .....	223.59	
		<hr/>
Total income tax .....	\$ 533.02	
Correct income tax liability .....	\$ 533.02	
Income tax assessed:		
Original, account No. 251650 .....	524.33	
		<hr/>
Deficiency of income tax .....	\$ 8.69	
		[14]

Statement.

Adjustment To Net Income  
Taxable Year Ended December 31, 1940

Net income as disclosed by return .....	\$ 7,389.42
Additional income:	
Partnership income .....	28,821.93
	<hr/>
Net income adjusted .....	\$36,211.35

Explanation Of Adjustment

Your share of the net income from the partnership of Hanna and Morton has been increased in the amount of \$28,821.93. Said partnership income is not entitled to be taxed under the provisions of section 107 of the Internal Revenue Code.

Computation Of Alternative Tax  
Taxable Year Ended December 31, 1940

Net income adjusted .....	\$36,211.35
Plus: Net long-term capital loss .....	2,040.01
<hr/>	
Ordinary net income .....	\$38,251.36
Less: Personal exemption .....	979.74
<hr/>	
Balance (surtax net income) .....	\$37,271.62
Less: Earned income credit .....	1,400.00
<hr/>	
Net income subject to normal tax .....	\$35,871.62
Normal tax at 4% on \$35,871.62.....	\$1,434.86
Surtax on \$37,271.62 .....	6979.63
<hr/>	
Partial tax .....	\$ 8,414.49
Minus: 30% of \$2,040.01 net long-term capital loss.....	612.00
<hr/>	
Alternative tax .....	\$ 7,802.49
<hr/>	
[15]	

Computation Of Tax  
Taxable Year Ended December 31, 1940

Net income adjusted .....	\$36,211.35
Less: Personal exemption .....	979.74
<hr/>	
Balance (surtax net income) .....	\$35,231.61
Less: Earned income credit .....	1,400.00
<hr/>	
Net income subject to normal tax.....	\$33,831.61
Normal tax at 4% on \$33,831.61.....	\$1,353.26
Surtax on \$35,231.61 .....	6,306.43
<hr/>	
Total normal tax and surtax .....	\$ 7,659.69
Alternative tax .....	\$ 7,802.49
Defense tax (10% of \$7,802.49).....	780.25
<hr/>	
Total income tax .....	\$ 8,582.74
Correct income tax liability .....	\$ 8,582.74
Income tax assessed:	
Original, account No. 203130 .....	5,106.48
<hr/>	
Deficiency of income tax .....	\$ 3,476.26
<hr/>	
[16]	



## EXHIBIT B

## EMPLOYMENT CONTRACT

This Agreement Of Employment made between the undersigned persons, hereafter referred to as the "clients", and Byron Hanna and Harold Morton, co-partners, practicing law under the name of Hanna and Morton, hereafter referred to as the "attorneys", Witnesseth;

Whereas, the clients desire to have the attorneys file the necessary suit (or suits) on behalf of the clients as plaintiffs for an accounting and damages, or other relief, arising out of the sale in 1915 and 1917 of certain parts of Section 24, Township 26 South, Range 20 East, M. D. B. & M., Kern County, California, against the Anglo & London-Paris National Bank, Herbert Fleishhacker, California Star Oil Company, Security Oil Company, and others, as defendants; and

Whereas, the clients and the attorneys desire to enter into an agreement respecting the fees and costs and expenses of such litigation;

Now, Therefore, it is agreed as follows:

#### Fees And Costs.

The clients will pay to the attorneys the sum of Thirty Thousand Dollars (\$30,000.00) and a contingent fee based on the amount of all sums or things of value recovered as a result of such suit (or suits) of 15% of the first million [17] dollars recovered and 10% of all sums in excess of one million dollars, payable only when and as received by the clients and in the same money or things of

value as are received by the clients. Of said \$30,000.00 the attorneys have heretofore been paid \$2,500.00, and the balance of \$27,500.00 will be paid forthwith upon the execution of this agreement.

The said attorneys agree that in consideration thereof they will bear and pay all expenses and costs of such suit or suits, including all appeals, and hold the clients harmless by reason thereof.

The said attorneys are authorized to do all things appearing to them to be necessary and proper in protecting the rights of the clients with respect to said suit (or suits) and they agree to diligently prosecute the same to their best ability.

#### Settlement.

Should a settlement of such controversies with the defendants be proposed or considered at any time, the question of whether such settlement should be made will be decided by a majority vote of the several clients and the attorneys, in which vote the attorneys shall have a 15% vote and the clients an 85% vote, the 85% being divided among the [18] clients in accordance with their respective interests in the controversies.

Provided further, that if any settlement be agreed upon, the attorneys shall receive a contingent fee of one-half of the amounts heretofore specified, that is to say, they will receiver 7½% of the first million dollars recovered, and 5% thereafter.

#### 1911 Sale.

The attorneys agree that in the prosecution and investigation of the 1915 and 1917 sales referred to,

they will endeavor to gather information as to the facts of a sale in 1911 made by the said Anglo & London-Paris National Bank of property in which the clients were interested. All such information will be placed at the disposal of the clients.

If it appears to the attorneys that a cause of action exists arising out of such 1911 sale, they will forthwith so advise the clients and will prepare the necessary complaint and prosecute a suit for relief by reason of such 1911 sale without further cash payment, upon an entirely contingent fee basis equal to that hereinbefore provided as to such 1915 and 1917 sales.

One or more duplicates of this agreement may be [19] signed. This contract effective only after signature of attorneys at Los Angeles, California.

[20]

State of of California,  
County of Los Angeles—ss.

Daisy May Hanna, being duly sworn, says that she is the petitioner above named; that she has read the foregoing petition, or had the same read to her, and is familiar with the statements contained therein, and that the statements contained therein are true except those stated to be upon information and belief, and that those she believes to be true.

DAISY MAY HANNA

Subscribed and sworn to before me this 6th day of February, 1943.

[Seal]                      ELSIE H. MACDONELL  
Notary Public in and for the County of Los  
Angeles, State of California

[Endorsed]: Filed T. C. U. S. Feb. 10, 1943. [21]

---

[Title of Tax Court and Cause]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) and (2). Admits the allegations contained in paragraphs (1) and (2) of the petition.

(3). Admits the allegations contained in paragraph (3) regarding the deficiencies asserted for the years 1939 and 1940, and understands that no question is now raised in this case regarding the year 1939.

(4). Denies the allegations of error contained in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5). Denies the allegations of fact contained in subparagraph A. to O., inclusive, of paragraph (5) of the petition, except that the respondent admits the facts stated in the second [22] unnumbered

paragraph of subparagraph J. of paragraph (5) of the petition.

(6). Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore it is prayed that the determination of the Commissioner be approved.

(Signed) J. P. WENCHEL, ACB  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

ALVA C. BAIRD,  
Division Counsel.  
EARL C. CROUTER,  
Special Attorney, Bureau of  
Internal Revenue.

ECC/fat 4/3/43

[Endorsed]: Filed T. C. U. S. April 8, 1943.

[23]

The Tax Court of the United States

Docket Nos. 739. 740

BYRON C. HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

A. Calder Mackay, Esq., and Adam Y. Bennion,  
Esq., for the petitioners.

Earl C. Crouter, Esq., for the respondent.

## MEMORANDUM FINDINGS OF FACT AND OPINION.

Hill, Judge: The Commissioner determined deficiencies of \$4,134.55 and \$3,476.26 in the income taxes of Byron C. Hanna and Daisy May Hanna, respectively, for the calendar year 1940. The sole question presented for our determination is whether respondent erred in denying application of section 107 of the Internal Revenue Code.



## FINDINGS OF FACT.

Byron C. Hanna and Daisy May Hanna, the petitioners, were husband and wife, residents of California during 1940 and all other times herein mentioned. They filed individual income tax returns for that year on the community property basis with the collector of internal revenue for the [24] sixth collection district of California. During the taxable year and all other years herein mentioned Byron C. Hanna and Harold G. Morton were law partners known by the firm name of Hanna and Morton.

In July 1932 Etienne Lang, as agent for the members of a Lazard family of France, consulted Hanna and Morton with reference to claims against the Anglo-California National Bank of San Francisco, Herbert Fleishhacker, its president, and others. These claims arose out of certain acts of the Bank and Fleishhacker as agents of the Lazards in the sale some 17 years earlier of lands in California belonging to the Lazards. At that time Lang employed Hanna and Morton to render an opinion on the validity of the claims and to draft a specimen form of complaint. Lang paid Hanna and Morton \$2,500 for these services. There was no obligation on the part of Lang or the Lazards to employ Hanna and Morton for further services and no obligation on the part of Hanna and Morton to accept such employment.

In October 1932, after consulting with other lawyers, Lang employed Hanna and Morton to proceed with the case. Lang and Morton agreed that

\$27,500 would be advanced to Hanna and Morton to cover costs and expenses, with the understanding that if any balance should remain at the conclusion of the employment, it would belong to Hanna and Morton. It was understood that Hanna and Morton received these funds for such purposes only and the accounts of Hanna and Morton dealing with the funds were frequently inspected by Lang. The books of Hanna and Morton designated the fund as a "Trust Account." The \$27,500 was paid over on October 15, 1932, and the receipt given for it read "Lazard Matter, On Account, Trust Acct." It was further agreed that Hanna and Morton would be responsible for any [25] expenses beyond the \$27,500. In addition to any balance remaining of the \$27,500 their fee was to be 15 per cent of the recovery.

For some time \$20,000 of the fund was left on deposit in the firm's name in two savings banks. Lang knew and approved of this. The funds were never kept in a separately designated trust account. Lang knew of this and acquiesced in it.

A total of \$1,168.86 in interest accrued on the savings accounts. During the years 1934 to 1936 Hanna and Morton withdrew this interest for their own unrestricted use having been told by Lang that they could keep it. They were to return it if it ever became necessary to complete the payment of expenses, their obligation in any event being to meet all expenses over the \$27,500. The interest so received was currently reported as income by Hanna and Morton. This interest was a fee for services



when it was so withdrawn by Hanna and Morton.

Lang agreed to the withdrawal of \$2,000 by Hanna and Morton as fees at the time the \$27,500 was first paid over in October 1932. Later in the same month an additional \$1,500 was withdrawn as a fee with Lang's approval. A further fee withdrawal of \$1,000 was made on May 1, 1933, with Lang's permission and again on October 31, 1936, Lang gave Morton his consent for the firm to withdraw \$1,000. Each of these fees was paid subject to the understanding that Hanna and Morton were to make up any deficits for expenses beyond the original amount paid to them for that purpose. They included these fees as compensation in their income tax returns in the years received.[26]

Hanna and Morton successfully tried the case for the Lazards and on January 19, 1940, the Bank paid \$746,354.95 in satisfaction of the judgment.

From this amount Hanna and Morton received on that day \$114,018.19, consisting of the contingent fee in the amount of \$111,588.84 and \$2,429.35 reimbursement of costs expended from the \$27,500 fund. At that time, exclusive of the reimbursement for costs, there was a balance of \$7,769.55 of the original \$27,500 which Hanna and Morton also received pursuant to the arrangement previously made. Thus, Hanna and Morton received fees of \$1,168.86 and \$5,500 prior to completion of the services in 1940 and \$121,787.74 on completion of these services in 1940.

Viewing the original payment of \$2,500 as being for a separate and distinct employment, addition

of these figures indicates that a total fee of \$128,456.60 was received by Hanna and Morton on this case. Of this amount, \$121,787.74, or 94.8 per cent, was paid on the completion of the services.

### OPINION.

The sole issue is whether petitioners are entitled to have their share of a fee for legal services received in 1940 taxed under the provisions of section 107 of the Internal Revenue Code.<sup>1</sup> In order for the section to apply "not less than 95 per centum" of the compensation must be paid only on completion of the services. The Regulations provide that "Section 107 is applicable only where at least 95 per cent of the total compensation for such services is paid on or after their completion."

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1. Section 107, Internal Revenue Code, added by section 220 of the Revenue Act of 1939:

Sec. 107. Compensation for Services Rendered for a Period of Five Years or More.

In the case of compensation (a) received, for personal services rendered by an individual in his individual capacity, or as a member of a partnership, and covering a period of five calendar years or more from the beginning to the completion of such services, (b) paid (or not less than 95 per centum of which is paid) only on completion of such services, [27] and (c) required to be included in gross income of such individual for any taxable year beginning after December 31, 1938, the tax attributable to such compensation shall not be greater than the aggregate of the taxes attributable to such compensation had it been received in equal portions in each of the years included in such period. [28]

Treasury Regulations 103, Sec. 19,107-1.

On the completion of their services for the Lazards in 1940 Hanna and Morton received a final fee of \$121,787.74. During the years 1932 through 1936 they received a total of \$6,668.86 in fees on the same case. The fact that Hanna and Morton were under the contingent liability of meeting any expenses after the exhaustion of the \$27,500 fund paid to them by Lang for expenses did not prevent the payments to them of \$5,500 from the principal of the fund and \$1,168.86 interest on the fund from being fees and income in the years in which received. Cf. *North American Oil Consolidated v. Burnet*, 286 U. S. 417; *Blum v. Helvering*, 74 Fed. (2d) 482, cert. denied 295 U. S. 732; *Highland Milk Condensing Co. v. Phillip*, 34 Fed. (2d) 777, cert. denied 280 U. S. 608.

Since the \$121,787.74 received on completion of the services is 94.8 per cent of \$128,456.60, the entire compensation, the petitioners fail to meet the explicit requirements of section 107.

Enter: Jan. 15, 1945.

Decisions will be entered for the respondent. [29]

The Tax Court of the United States  
Washington

Docket No. 740

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion entered January 15, 1945, it is

Ordered and Decided: That there is a deficiency in income tax for the calendar year 1940 in the amount of \$3,476.26.

/s/ SAMUEL B. HILL,  
Judge.

Entered Jan. 15, 1945.

Copies Served on Both Parties. [30]

United States Circuit Court of Appeals  
for the Ninth Circuit

No. 740

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

PETITION FOR REVIEW OF DECISION OF  
THE TAX COURT OF THE UNITED  
STATES

To the Honorable Judges of the United States  
Circuit Court of Appeals for the Ninth Circuit:  
Comes now Daisy May Hanna, petitioner  
herein, and respectfully shows:

I.

NATURE OF THE CONTROVERSY

The Respondent determined a deficiency in the income tax against the Petitioner for the calendar year 1940 in the amount of \$3,476.26.

This deficiency arose from the denial of the application of Section 107 of the Internal Revenue Code to petitioners' community interest in a fee received in the calendar year 1940 by the firm of Hanna and Morton, lawyers, of which firm the petitioner's husband, Byron C. Hanna, is a partner.

In a companion proceeding the Commissioner also [31] determined a deficiency of \$4,134.55 in the income tax of Byron C. Hanna, husband of peti-

tioner, for the calendar year 1940, arising from the denial to said Byron C. Hanna of the application of Section 107 of the Internal Revenue Code in his return of his community interest in the said fee received during the calendar year 1940.

Petitioner and her said husband, Byron C. Hanna, each filed an appeal to The Tax Court of the United States, which appeals were upon the trial thereof consolidated for trial and opinion.

Thereafter, on January 15, 1945, The Tax Court of the United States rendered its decision in favor of the respondent, and a copy of said decision is attached to this petition. Said decision describes in detail the controversy involved, which briefly, is as follows:

In October, 1932 Harold C. Morton and Byron C. Hanna were each attorneys at law, admitted to practice as such in all courts of the State of California and in the United States District Courts in the State of California and in the Circuit Court of Appeals for the Ninth Circuit, and were engaged in the practice of law in the City of Los Angeles, under the firm name and style of Hanna and Morton.

In October, 1932 Hanna and Morton were employed to prosecute a certain action against the Anglo-California National Bank of San Francisco and Herbert Fleishhacker. [32] At that time they received \$27,500 in trust to be utilized for expenses in said litigation. The litigation was instituted and continued until 1940, during which year it was successfully concluded.



During the period of the pendency of the litigation Hanna and Morton were also employed by the same clients to prosecute other actions and legal proceedings separate and distinct from the specific employment above referred to.

During the period of the pendency of the specific litigation above referred to, Hanna and Morton were permitted by their clients to withdraw from the trust funds various amounts thereof, aggregating \$5,500. Said withdrawals were made with the understanding and upon the agreement that Hanna and Morton would reimburse the trust fund for the amount thereof if required for the payment of costs.

During said period interest accrued in the total amount of \$1,168.86 on the deposit of said trust funds in savings accounts, and Hanna and Morton were permitted by their clients to withdraw this amount with the understanding and upon the promise that it would be returned if necessary for the payment of expenses.

Upon the conclusion of the litigation Hanna and Morton received a fee of \$121,787.74 for their services under said specific employment, plus release of the obligation to return the interest withdrawn as aforesaid and to reimburse the trust fund for the amounts withdrawn as aforesaid, making [33] a total of \$128,456.60.

The Tax Court of the United States decided that the total fee received by Hanna and Morton in said employment was the latter amount, and that of this amount only \$121,787.74, or 94.8 per cent, was paid

on the completion of the services. There was thus decided to be a deficit of one-fifth of one per cent ( $1/5$  of 1%) of the amount necessary to be received upon the completion of the services to entitle petitioner to the benefit of the provisions of Section 107 of the Internal Revenue Code.

Petitioner contends that The Tax Court erred in the following particulars:

(a) in finding as a fact or deciding as a matter of law that the withdrawals aforesaid from the trust funds, amounting to \$5,500, constituted payment of a part of the fee for the services rendered in the employment in question to Hanna and Morton when and as received by Hanna and Morton;

(b) in finding as a fact or deciding as a matter of law that the withdrawal of accrued interest on the trust fund, as aforesaid, amounting to \$1,168.86, constituted payment of a part of the fee for the services rendered in the employment in question to Hanna and Morton when and as received by Hanna and Morton; and

(c) in determining that less than 95% of the fee of Hanna and Morton for services under the employment [34] above-mentioned was received in the calendar year 1940.

## II.

### THE COURT IN WHICH REVIEW IS SOUGHT

The United States Circuit Court of Appeals for the Ninth Circuit is the Court in which review of



said decision of The Tax Court of the United States is sought pursuant to the provisions of Section 1141 of the Internal Revenue Code.

### III.

#### VENUE

The decision of the United States Tax Court herein was rendered on January 15, 1945. For more than thirty years last past immediately preceding, petitioner has resided in the County of Los Angeles, State of California. She filed her Federal Income Tax returns for the calender year 1940, and also for all other calendar years since 1916 or thereabouts, with the United States Collector of Internal Revenue for the Sixth Collection District of California, whose office is located at Los Angeles, California and within the Ninth Judicial Circuit of the United States.

The parties hereto have not stipulated that said decision may be reviewed by any Court of Appeals other than the one herein designated. [35]

Wherefore, the Petitioner prays that the decision of The Tax Court of the United States herein be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and rules of said Court and transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

Dated: April 7, 1945.

A. CALDER MACKAY

ADAM Y. BENNION

Attorneys for Petitioner.

[Endorsed]: Filed T. C. U. S. April 12, 1945.

[36]

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The Tax Court of the United States

Docket Nos. 739, 740.

BYRON C. HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

A. Calder Mackay, Esq., and Adam Y. Bennion, Esq., for the petitioners. Earl C. Crouter, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND  
OPINION

Hill, Judge: The Commissioner determined deficiencies of \$4,134.55 and \$3,476.26 in the income

taxes of Byron C. Hanna and Daisy May Hanna, respectively, for the calendar year 1940. The sole question presented for our determination is whether respondent erred in denying application of section 107 of the Internal Revenue Code.

### FINDINGS OF FACT.

Byron C. Hanna and Daisy May Hanna, the petitioners, were husband and wife, residents of California during 1940 and all other times herein mentioned. They filed individual income tax returns for that year on the community property basis with the collector of internal revenue for the sixth collection district of California. During the taxable year and all other years herein mentioned Byron C. Hanna and Harold C. Morton [37] were law partners known by the firm name of Hanna and Morton.

In July 1932 Etienne Lang, as agent for the members of a Lazard family of France, consulted Hanna and Morton with reference to claims against the Anglo-California National Bank of San Francisco, Herbert Fleishhacker, its president, and others. These claims arose out of certain acts of the Bank and Fleishhacker as agents of the Lazards in the sale some 17 years earlier of lands in California belonging to the Lazards. At that time Lang employed Hanna and Morton to render an opinion on the validity of the claims and to draft a specimen form of complaint. Lang paid Hanna and Morton

\$2,500 for these services. There was no obligation on the part of Lang or the Lazards to employ Hanna and Morton for further services and no obligation on the part of Hanna and Morton to accept such employment.

In October 1932, after consulting with other lawyers, Lang employed Hanna and Morton to proceed with the case. Lang and Morton agreed that \$27,500 would be advanced to Hanna and Morton to cover costs and expenses, with the understanding that if any balance should remain at the conclusion of the employment, it would belong to Hanna and Morton. It was understood that Hanna and Morton received these funds for such purposes only and the accounts of Hanna and Morton dealing with the funds were frequently inspected by Lang. The books of Hanna and Morton designated the fund as a "Trust Account." The \$27,500 was paid over on October 15, 1932, and the receipt given [38] for it read "Lazard Matter, on Account, Trust Acct." It was further agreed that Hanna and Morton would be responsible for any expenses beyond the \$27,500. In addition to any balance remaining of the \$27,500 their fee was to be 15 per cent of the recovery.

For some time \$20,000 of the fund was left on deposit in the firm's name in two savings banks. Lang knew and approved of this. The funds were never kept in a separately designated trust account. Lang knew of this and acquiesced in it.

A total of \$1,168.86 in interest accrued on the savings accounts. During the years 1934 to 1936 Hanna and Morton withdrew this interest for their

own unrestricted use having been told by Lang that they could keep it. They were to return it if it ever became necessary to complete the payment of expenses, their obligation in any event being to meet all expenses over the \$27,500. The interest so received was currently reported as income by Hanna and Morton. This interest was a fee for services when it was so withdrawn by Hanna and Morton.

Lang agreed to the withdrawal of \$2,000 by Hanna and Morton as fees at the time the \$27,500 was first paid over in October 1932. Later in the same month an additional \$1,500 was withdrawn as a fee with Lang's approval. A further fee withdrawal of \$1,000 was made on May 1, 1933, with Lang's permission and again on October 31, 1936, Lang gave Morton his consent for the firm to withdraw \$1,000. Each of these fees were paid subject to the understanding that Hanna and Morton were to make up any [39] deficits for expenses beyond the original amount paid to them for that purpose. They included these fees as compensation in their income tax returns in the years received.

Hanna and Morton successfully tried the case for the Lazards and on January 19, 1940 the Bank paid \$746,354.95 in satisfaction of the judgment. From this amount Hanna and Morton received on that day \$114,018.19, consisting of the contingent fee in the amount of \$111,588.84 and \$2,429.35 reimbursement of costs expended from the \$27,500 fund. At that time, exclusive of the reimbursement for costs, there was a balance of \$7,769.55 of the original



\$27,500 which Hanna and Morton also received pursuant to the arrangements previously made. Thus, Hanan and Morton received fees of \$1,168.86 and \$5,500 prior to completion of the services in 1940 and \$121,787.74 on completion of those services in 1940.

Viewing the original payment of \$2,500 as being for a separate and distinct employment, addition of these figures indicates that a total fee of \$128,456.60 was received by Hanna and Morton on this case. Of this amount, \$121,787.74, or 94.8 per cent, was paid on the completion of the services.

### OPINION

The sole issue is whether petitioners are entitled to have their share of a fee for legal services received in 1940 taxed under the provisions of section 107 of the Internal Revenue [40] Code.<sup>1</sup> In order

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1. Section 107, Internal Revenue Code, added by section 220 of the Revenue Act of 1939;

Sec. 107. Compensation for Services Rendered for a Period of Five Years or More.

In the case of compensation (a) received, for personal services rendered by an individual in his individual capacity, or as a member of a partnership, [41] and covering a period of five calendar years or more from the beginning to the completion of such services, (b) paid (or not less than 95 per centum of which is paid) only on completion of such services, and (c) required to be included in gross income of such individual for any taxable year beginning after December 31, 1938, the tax attributable to such compensation shall not be greater than the aggregate of the taxes attributable to such compensation had it been received in equal portions in each of the years included in such period.

for the section to apply "not less than 95 per centum" of the compensation must be paid only on completion of the services. The Regulations provide that "Section 107 is applicable only where at least 95 per cent of the total compensation for such services is paid on or after their completion." Treasury Regulations 103, Sec. 19,107-1.

On the completion of their services for the Lazards in 1940 Hanna and Morton received a final fee of \$121,787.74. During the years 1932 through 1936 they received a total of \$6,668.86 in fees on the same case. The fact that Hanna and Morton were under the contingent liability of meeting any expenses after the exhaustion of the \$27,500 fund paid to them by Lang for expenses did not prevent the payments to them of \$5,500 from the principal of the fund and \$1,168.86 interest on the fund from being fees and income in the years in which received. Cf. *North American Oil Consolidated v. Burnet*, 286 U. S. 417; *Blum v. Helvering*, 74 Fed. (2d) 482, cert. denied 295 U. S. 732; *Highland Milk Condensing Co. v. Phillip*, 34 Fed. (2d) 777, cert. denied 280 U. S. 608.

Since the \$121,787.74 received on completion of the services is 94.8 per cent of \$128,456.60, the entire compensation, the petitioners fail to meet the explicit requirements of section 107.

Decisions will be entered for the respondent.

Entered Jan. 15, 1945.

[Endorsed]: Filed T. C. U. S. April 12, 1945.  
[42]



United States Circuit Court of Appeals  
for the Ninth Circuit

T. C. No. 740

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

NOTICE OF FILING PETITION  
FOR REVIEW

To John P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C., Attorney for the Respondent:

Please Take Notice that on the 12th day of April, 1945, the undersigned filed with the Clerk of the Tax Court of the United States the petition of Daisy May Hanna, a copy of which is annexed hereto, for the review by the United States Circuit Court of Appeals for the Ninth Circuit of the final order and decision of the Court heretofore rendered in the above entitled case. Dated this 13th day of April, 1945.

A. CALDER MACKAY  
ADAM Y. BENNION

Attorneys for the Petitioner

ADMISSION OF SERVICE

Service of a copy of the above notice and a copy of the petition for review is hereby accepted this 13th day of April, 1945.

J. P. WENCHEL C. A. R.

Chief Counsel Bureau of Internal Revenue

Attorney for the Respondent.

[Endorsed]: Filed T.C.U.S., April 13, 1945. [43]

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The Tax Court of the United States

No. 740

DAISY MAE HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REPENUE,  
Respondent.

STATEMENT OF EVIDENCE

Following is a statement of evidence in narrative form in the above entitled cause.

This cause came on for hearing before Honorable Sam B. Hill, Judge of the Tax Court of the United States, on April 27 and 28, 1944. Messrs. A. Calder Mackay, Adam Y. Bennion, and Arthur McGregor appeared on behalf of Petitioner, and Earl C. Crouter, Esq. appeared on behalf of the Respondent.

Before any witness was called to testify, this cause was ordered consolidated for trial and opinion with a companion case before The Tax Court of the United States, entitled, "Byron C. Hanna, Petitioner, v. Commissioner of Internal Revenue, Respondent," Number 739.

Whereupon,

HAROLD C. MORTON

was called as a witness by and on behalf [44] of the Petitioners; and having been first duly sworn, was examined, and testified as follows:

Direct Examination

My name is Harold C. Morton. I have been for almost twenty-eight years and am now a practicing lawyer. Since about June 1932 I have been a partner of Byron C. Hanna under the firm name of Hanna and Morton.

I have been acquainted with Mr. Etienne Lang since July of 1932. He consulted me at that time with regard to claims that the members of his family, the Lazard family of France, might have against Herbert Fleishhacker, the Anglo-California Bank of San Francisco, and certain other persons who had purchased properties from the Lazard family in 1915 and 1917.

He consulted me at that time about the validity of the claim, and specifically employed us to advise him as to our views, and to draft the kind of a complaint that would be filed in such case in order that he might send it to a Mr. LePaulle, an attorney in France who represented the family.

(Testimony of Harold C. Morton.)

Mr. Lang was very explicit, that his employment of us at that time was wholly for the purpose of giving advice and drafting this complaint, and we agreed upon a fee of \$2,500 to cover that specific work. We were paid \$2,500. Our records will show the exact date. [45] That particular work was done and submitted to him; that is, I gave him my opinion as to where they stood in the matter and did draft a complaint which I delivered to him and which he took with him.

The office gave him a receipt on the stationery bearing the name Fredericks, Hanna and Morton. This was the name of our firm prior to June, 1932.

A photostatic copy of the receipt was identified by the witness and admitted in evidence as Petitioner's Exhibit 1. It reads, so far as material:

"No. 10786

Los Angeles, California

August 19, 1932.

"Received of Lazard matter the sum of \$2,500 on account.

Fredericks, Hanna and Morton

By H.C.M."

I did not see Mr. Lang from the time I delivered the draft of the complaint to him, which would be sometime in August, until the month of October. When I delivered the complaint to Mr. Lang he informed me that no definite decision had been made whether to file suit or to employ our firm.

He returned in October and said that he finally

(Testimony of Harold C. Morton.)

had decided to file suit and that in the meantime he had made investigations of our firm which had been quite [46] complimentary and he had been authorized by his family to employ us to bring the suit which had been discussed.

At that time (in October) and after discussions back and forth of various plans on which we might handle the employment, I told him we would handle it for a fee of fifteen percent of the recovery, provided they would put up the estimated costs and expenses of the litigation, which I expected and we discussed would be very heavy in view of the personalities involved, the ancient history involved, because we were talking then in 1932 about a transaction which had occurred in 1915, and the influence of the people against whom the proceeding would be brought.

We discussed that back and forth and finally agreed upon the figure that they would put up of \$27,500. Mr. Lang, who is a very precise little Frenchman, was quite insistent that the money be handled in such a manner that it would be used to defray the expenses, with the understanding that at the end of the road, if there was anything left over, it would be ours, which I agreed to.

I explained to him that we received clients' moneys from time to time for expenses of litigation, and while we put them in general accounts, we always carry them on our records as trust funds; that we would do the same with this amount and that he would have access to that record at all times.

(Testimony of Harold C. Morton.)

We agreed upon the matter, and at his request thereafter on frequent occasions he did have access to the records [47] which were thereafter maintained.

I know it was in the month of October of that year that we received the \$27,500. You have produced a receipt which is dated October 15, 1932 for \$27,500, which says, "Lazard matter, on account, Trust Account," and I of course from that fixed the date as October 15th and that we received the money, so these conversations and negotiations which I had with Mr. Lang upon his return and the time he said they were going to definitely employ us were prior to October 15th. I remember getting the check in San Francisco and I know I went to San Francisco with Mr. Lang after we had orally agreed upon the matter and so on in October.

A photostatic copy of the receipt for \$27,500 was received in evidence as Petitioner's Exhibit 2. This exhibit reads, so far as material:

"No. 10797

Los Angeles, Cal.

October 15, 1932.

"Received of Lazard matter the sum of  
\$27,500.00 on account trust acct.

Fredericks, Hanna and Morton

By H.C.M."

Our system of records at the time we are talking about consisted of when money was received a receipt being given therefor, such as the previous two



(Testimony of Harold C. Morton.)

exhibits [48] you have hereinbefore introduced; a daily financial report rendered to Mr. Hanna and to me which would show all moneys on hand and all trust accounts at that time, and the banks the moneys were in usually, although sometimes the bank accounts were lumped together, and a statement of the previous day's receipts and the previous days expenditures itemized. As far as clients' cards were concerned we maintained a sort of loose-leaf card system with the name of the client or the matter on, on which moneys which came in would be entered and money which went out which was chargeable against would be entered.

We also maintained a trust account. At all times we wanted to know how much money in the account was ours and how much was others. You will always find shown on our daily statements how much the trusts were and then the net balance showing what the firm of Hanna and Morton had.

The document you show me is a photostat of the original of our daily financial report of August 19, 1932, which is one incidentally which says, Receipt No. 10785, which I believe is the receipt you marked Exhibit 1 ("H.C.M.") which refers to Harold C. Morton, "Received from Lazard matter the amount of \$2,500.00."

A photostatic copy of the daily financial report of Augsut 19, 1932 was received in evidence as [49] Petitioner's Exhibit 3. In so far as material, it shows total funds on hand in the amount of \$2,716.61; trust fund, \$566.30; net balance, \$2,150.31.



(Testimony of Harold C. Morton.)

Under the title, "Funds received" it shows the following entry:

"Receipt No.	By Whom	From Whom	Trust	Amount
10786	H.C.M.	Lazard Matter,		\$2500.00"

Under the title, "Funds expended" the following entries appear:

"Check No.	To Whom	Charged to Whom	Amount
348	H. C. Morton	Expense,	\$1000.00
349	Byron C. Hanna,	Expense,	1000.00"

The statement also contains other items under the title, "Funds expended", the total of all items under that title being \$2,252.22.

These are photostatic copies of our daily financial reports for October 14, 15 and 17 of 1932. The October 14th one is the day before we received the \$27,500 and it shows certain moneys and on that occasion showed the trust fund amounted to \$543.04. The next one, October 15th, 1932, shows the receipt by Receipt No. 10,797, which I think was your Exhibit 2 here, "By Harold C. Morton, the Lazard matter" with the heading, "Trust \$27,500.00". The October 17th one is the one after, undoubtedly the 15th was a Saturday, from the order in which you have produced these, and shows a trust fund at that time of \$26,000.00 and some odd dollars.

These three photostatic copies of the daily [50] financial reports were received in evidence as Petitioner's Exhibit No. 4. The report of October 14th, 1932 shows total funds on hand, \$1,476.25; trust fund, \$543.04; net balance, \$933.21. The report of October 15, 1932 shows total funds on hand in

(Testimony of Harold C. Morton.)

the amount of \$26,174.05; Trust fund, \$26,043.04; net balance, \$131.01. Under the title, "Funds received" the following entry appears:

"Receipt No.	By Whom	From Whom	Trust	Amount
10797	H.C.M.	Lazard Matter, Trust,		\$27,500.00"

Under the title, "Funds expended" the following entries appear:

"Check No.	To Whom	Charged to Whom	Amount
365	Byran C. Hanna,	Lazard Trust,	\$ 1,000.00
366	Harold C. Morton,	Lazard Trust,	1,000.00
640	Bank of America		
		To Savings Account, Tr	10,000.00
641	Security First Nt.		
		To Savings Account, Tr	10,000.00

There are other entries of funds expended and the total funds expended were \$22,802.00. The report of October 17, 1932 shows total funds on hand in the amount of \$26,078.34; Trust Fund, \$26,043.04; net balance, \$35.30. Other entries of funds received and expended are immaterial to the present case.

This is one of our loose-leaf sheets which we carry for each client or matter. It is headed, "Fredericks & Hanna" being still an older firm than Fredericks, Hanna and Morton, but the stationery had been carried over and used. It is marked "Lazard Matter" and has the heading "Trust Account". [51] The first entry is August, on account, the word, "retainer" written in by an apparently different type-writer, of "\$2,500.00" a debit and a credit. Then balanced out. I might explain the trust account was not out there until a subsequent date; when the matter was set up the \$27,500 was set up on the

(Testimony of Harold C. Morton.)

card. That was on October 15th, when it was received. I can explain the three items on this ledger card of \$1,000, \$1,000, and \$1,500.

When we discussed the \$27,500 I discussed with Mr. Lang the matter of Mr. Hanna and I each withdrawing some of that money because we would be expending time and expenses which would not appear on the card as such and told him we would like to draw \$5,000. He discussed that with me and we agreed that instead we would at that time each take \$1,000 from this trust account, and in the latter part of the month we agreed to another \$1,500 with the understanding between Mr. Lang and myself that were it necessary, of course those moneys would be restored and we would complete the payment of all expenses which might be incurred.

The ledger card was received in evidence as Petitioner's Exhibit No. 5. It bears the number 852 A. The name, "Lazard Matter" and the title, "Trust Account." Under date of August 19, 1932 appears the entry, "On account, retainer 10786" and under the heading, "Charges" \$2,500.00; and under the heading "Credits" \$2,500.00; and under the heading, "Balance" nothing. [52]

Under date of October 15, 1932 there is an entry entitled "Byron C. Hanna, Tr Retainer 395 \$1,000" inserted under the heading entitled "Charges." A similar entry for a similar amount immediately follows with the name "Harold C. Morton" in place of Byron C. Hanna. The account also contains an entry on October 15, 1932 reading, "On account

(Testimony of Harold C. Morton.)

Trust, 10797" and under the heading "Credits" \$27,500.00. There is also an entry under date of October 31, 1932 entitled "To Attorneys fees, Trust Acct," and under the heading "Charges" \$1,500.

Ledger Card No. 852 B is the same account at a subsequent period. Referring to a withdrawal, "H & M from Lazard, \$1,000" dated May 1, 1933, we drew the following year that amount under like circumstances as I have described with respect to the withdrawals in the first month in which we had the trust fund.

This ledger card was received in evidence as Petitioner's Exhibit 6. It bears the number 852 B, the name, "Lazard Matter", the designation, "Trust Account". It contains an entry under date of May 1, 1933 reading "Withdraw. H & M from Lazard," and under the column designated "Charges", "\$1,000.00."

Referring to the card headed "Hanna and Morton" "1328" we finally used up all the old stationery. That is just a continuation of that account only for 1936. Referring to an item dated October 31, 1936 of \$1,000.00, that [53] was handled under like circumstances. Wherever those withdrawals occurred they were discussed with Mr. Lang, who represented the Lazard family.

This card was received in evidence as Petitioner's Exhibit 7. It is numbered 1328 B, bears the name "Lazard Trust" and the designation, in parenthesis, "General a/c—Fleishhacker." It contains an entry

(Testimony of Harold C. Morton.)

under date of October 31, 1936, reading, "Trans. from Trust—fee", and under the heading, "Charges," "1,000.00."

The card No. 784 which is headed "Trust Department" is the card the bookkeeper keeps to keep track of how much money we have of all clients in trust, and you will find the names of various clients and amounts in and out, together with a running balance of the trust amounts we hold for clients, which amounts conform or should conform with the amount shown on our daily financial sheet which Mr. Hanna and I receive each day. The item of October 15, \$27,500, is the same item to which I testified we agreed to and did put in trust in October in connection with these Lazard matters.

With reference to the item, "B.C.H. and H.C.M. Salary, Lazard \$2,000", I don't know why the word "salary" would be there, but the \$2,000 was the \$2,000 we withdrew at that time under the circumstances I related a moment ago.

This ledger card was received in evidence as Petitioner's Exhibit No. 8. It bears the number 784 and the [54] designation. "Trust Department." It contains an entry under date of October 15, 1932, entitled, "Lazard Matter 10953" and in the column under the designation, "Credits", \$27,500. The next entry is also dated October 15, 1932, and bears the designation, "B.C.H. and H.C.M. Salary, Lazard 395-6", and in the column under the designation, "Charges" appears the figure 2,000.00. It also contains an entry under date of October 31, 1932, read-



(Testimony of Harold C. Morton.)

ing, "Chg. Lazard Matter Attys fees" and opposite that in the column under the designation, "Charges", the figures 1500.00.

Card No. 883, entitled "Trust Account" is a continuation of the same account. The item of May 1, 1933, entitled, "Withdrawal H & M from Lazard, \$1,000.00" is the same item which I identified as of the same date a few moments ago, withdrawn after discussion and approval from Mr. Lang.

This ledger card was received in evidence as Petitioner's Exhibit No. 9. It bears the number 883 and the designation, "Trust Account." Under the date May 1, 1933 appears an entry entitled, "Withdrawal H & M from Lazard", and in the column under the heading "Charges" appears the entry of \$1,000.

Referring to Exhibit 8, the item of October 31, 1932 of \$1,500 charged Lazard matter attorneys fees is the item we took at the end of October that I testified to previously. That is, October of 1932, with Mr. Lang's [55] approval.

In October 1932 I submitted a contract to Mr. Lang and he initialled it. He was the agent and had power of attorney from these various people in France, but it was desired to have the contract sent to France and there signed, if possible, by as many of the parties of interest themselves. So, at that time a contract was drawn which Mr. Lang initialled and okayed and then copies of that were sent to France, and I think many, many months later we received the one back with various signa-

(Testimony of Harold C. Morton.)

tures on it. This document is a photostat of the form of contract which I drew at the time and which Mr. Lang marked "O.K. Etienne Lang", and I signed, "Hanna and Morton by Harold Morton."

This photostatic copy of the employment agreement was received in evidence as Petitioner's Exhibit No. 10. An exact copy of Petitioner's Exhibit No. 10, omitting date and signatures, is attached to the petition filed herein by Petitioner with The Tax Court of the United States as Exhibit B. The provisions of that agreement with reference to the payment of fees and costs are as follows:

#### "FEES AND COSTS.

The clients will pay to the attorneys the sum of Thirty Thousand Dollars (\$30,000.00) and a contingent fee based on the amount of all sums [56] or things of value recovered as a result of such suit (or suits) of 15% of the first million dollars recovered and 10% of all sums in excess of one million dollars, payable only when and as received by the clients and in the same money or things of value as are received by the clients. Of said \$30,000.00 the attorneys have heretofore been paid \$2,500.00, and the balance of \$27,500.00 will be paid forthwith upon the execution of this agreement.

The said attorneys agree that in consideration thereof they will bear and pay all expenses and costs of such suit or suits, including all appeals, and hold the clients harmless by reason thereof.



(Testimony of Harold C. Morton.)

The said attorneys are authorized to do all things appearing to them to be necessary and proper in protecting the rights of the clients with respect to said suit (or suits) and they agree to diligently prosecute the same to their best ability."

The document you now hand me is the one that came back months later, signed by various members of the family themselves.

This document was received in evidence as Petitioner's Exhibit 11. It is identical with Exhibit 10 except as to date and signatures, and except also that immediately following the provisions of Exhibit 10 above set forth there appears in Exhibit 11 an additional paragraph [57] reading as follows:

"The said attorneys are hereby empowered and authorized to take all steps that, in their opinion, may be deemed proper to enforce the verdict and judgment that may eventually be rendered in favor of the clients."

Referring to Exhibit 11 and to the language, "The clients will pay to the attorneys the sum of \$30,000, etc.", we did not receive \$30,000, we received \$27,500 to put in trust. The \$30,000 figure was included in here at Mr. Lang's request. He wanted this contract to show how much total he had paid out up to that time in connection with the case.

The \$2,500 we received had nothing to do with the present employment on that contract. As I stated before, it was distinctly understood when we

(Testimony of Harold C. Morton.)

were employed in July and were paid the \$2,500 in August that there was no obligation on either party beyond that time. He was very definite. He said first they might not bring the suit, and second, they might not employ us as counsel. There is a particular circumstance in connection with this whole litigation that makes it simple for me to remember that exact situation, that we were not employed until October to bring a lawsuit.

The \$27,500 figure to be put in trust for expenses [58] was only arrived at after discussion in which I had outlined verbally to Mr. Lang and discussed at length the various items of expense that may or might be incurred in connection with this litigation. Some of them were the fact that the matters would require a great deal of expense for investigation of the values of these properties which had been sold in 1915 and 1917. The fact that it would be necessary to canvass old-timers in Kern County oil operations with a view to ascertaining witnesses. The fact that it would involve a large expense in the taking of depositions, undoubtedly a trip to Paris to take depositions of members of the family. And that it was litigation, the extent of which could only be guessed at, that is what I was doing, was making the best estimate or guess that I could.

The question of the value of the properties at the time of sale entered into it. This lawsuit involved a parcel of land situated in Kern County for which Fleishhacker and the Anglo Bank for years had been the agents for the people in France for that

(Testimony of Harold C. Morton.)

and other properties, having been paid an annual fee of \$3,000 to look after the properties. In 1915 they had sold 110 acres of this property for \$300 an acre, in fee. It was our contention that the land was worth at least \$3,000 an acre at that time, and that that fact was known to the agents of the Lazard family; hence the fraudulent conduct. [59] So there was the matter of going back all these years to establish the value of the property at that time, because subsequently, after the sale it proved to be very valuable oil property, and the necessity, of course, was to show that it was known to be such at the time of those sales many years before. I explained to him that it would be most difficult to get people for witnesses because of the power and influence of Herbert Fleishhacker in this State. In fact, Mr. Lang told me that he had been informed in San Francisco by three different sets of counsel that they would not take this case because it would be impossible to beat Herbert Fleishhacker in the courts of California. I assured him that I had confidence in the Federal Courts, and that would be where we would proceed, but those facts were discussed as facts which would call for, we believed, substantial expenditures to prepare the case and try the case and to fight appeals or to take appeals.

We were employed in October, definitely on it. The complaint was filed the following January. The case was tried at the end of 1937. That is, when the actual trial took place. During all those intervening years there were numerous proceedings in

(Testimony of Harold C. Morton.)

Court of the usual nature when you get a case that involves charges of fraud against prominent people with many lawyers involved, questions of our right to take depositions, questions of sufficiency of pleadings, [60] the taking of depositions, examination here and there.

The case was on trial I don't remember exactly but my impression is it was six or seven weeks in the Federal Court in this District here. The decision of the Trial Court was rendered in December 1937, and was rendered from the Bench by the Court stopping my final argument and forthwith rendering a decision and finding the defendants guilty of fraud.

Appeals were taken in the usual manner, and we finally got a check in January, 1940. The judgment at the time in the Trial Court was in round figures, \$650,000. When we got the check interest had increased it to \$746,354.94.

Referring to Exhibit 5, which is the card with No. 852 A at the top of it, and to the item of \$2,500 and also referring to Exhibit 8, which I have identified heretofore as the Trust Control Account, the item of \$2,500 which was received on August 19, 1932, does not appear on Exhibit 8, the Trust Control Account, for the reason that that item was never a trust item.

Referring to Exhibit 5, the \$2,500 is the first item there, on August 19, 1932, but the heading, "Trust Account" above, that was never put on this account

(Testimony of Harold C. Morton.)

until October, when we received the \$27,500. What occurred was the bookkeeper used the same ledger sheet that she had put the \$2,500 on, when this \$27,500 was received, and [61] inasmuch as that was a trust account, she at that time put that heading on that sheet.

On January 19, 1940, at the conclusion of this litigation, we received a free of \$121,700 and some odd dollars, made up of our 15% recovery on the large check that I identified, plus the fact that at that time we became the owners of the balance in the trust account pursuant to my arrangement with the clients.

#### Cross-Examination

When this Lazard matter first came up, in 1932, Byron C. Hanna and Harold C. Morton were the members of the firm of Hanna and Morton, and no one else. Mr. Lang first conferred with me and I believe I am the only one he ever conferred with until long afterwards he may have had conversations with Mr. Hanna. I handled the matter in its entirety as far as the members of the firm were concerned, from beginning to end.

Mr. Lang represented a number of relatives of his who were residents of France, which we describe generally as the Lazard family. There was no one else in this country with whom Mr. Hanna or I dealt directly. Mr. Lang came to us with powers of attorney under which he was acting representing these members of this family. He had been sent to this country by the members of the family



(Testimony of Harold C. Morton.)

as their agent to investigate this matter in 1931. I [62] believe his powers of attorney, most of them, were dated then. I have them.

I would say it was approximately one month after my initial conversations with Mr. Lang that the first \$2,500 was paid. He came to us in July and that payment was made in August. Mr. Hanna did not participate in any of those discussions or do any work in connection with the investigation up to the time of payment.

Mr. Lang came to us with a written opinion from the firm of Heller, Ehrman, White & McAuliffe, of San Francisco, and handed that opinion to me plus recitals of facts or possible facts and our discussions went from there and my opinions were given verbally along the line of the questions which had been presented in this other opinion from San Francisco counsel presented by Mr. Lang.

The \$2,500 was paid to us under the express understanding that it was for the advice I then gave him plus the preparation of this complaint, with the understanding that we were not employed to do anything further, and whether he came back and we were employed to conduct the litigation was entirely optional with them. He made it very clear that he was then investigating and was going to continue to investigate counsel, meaning us, and also that it was uncertain whether the members of the family would bring this litigation because they for many years had been very friendly with the Fleishhackers. They [63] had founded this bank in

(Testimony of Harold C. Morton.)

San Francisco, this family had, and had sold it to Herbert Fleishhacker's father-in-law in 1906. There existed for many, many years a cordial relationship which, of course, was about to be breached if such litigation would ensue. That was all explained to me by Mr. Lang.

The \$2,500 was paid after the fixed fee had been agreed upon and the work was being performed. I undoubtedly was working on the draft of the complaint at the time because the check was paid to me after we had agreed upon the amount and the work that needed to be done. I know the complaint was prepared by the end of August and it was a very voluminous affair.

That particular draft wasn't held until January 1933. That was delivered to Mr. Lang and he took it with him at the end of August. When we were subsequently actually employed to conduct this litigation, of course new pleadings were prepared, and finally, in January, I filed suit. It was all regarding the same subject matter, the oil lands in Kern County.

Exhibit 1 is not in my handwriting. It is in the handwriting of our then bookkeeper. The H.C.M. represents me. We have a system there. If I take in money in the firm a particular receipt book is used and the bookkeeper makes up the receipt and puts my initials on it. Mr. Hanna always writes his own receipts. I haven't [64] written one of those in many years. The bookkeeper makes them out. So that was made by Miss Goodyear, who was



(Testimony of Harold C. Morton.)

our then bookkeeper. You will have to ask Miss Goodyear what was mean by "on account. All I did was hand her \$2,500 and ask her to write a receipt for it and give it to Mr. Lang. It was on account and full payment of the services which we had agreed to do, as I have outlined to you two or three times. I mean it was merely for our record of our account to show money received. That \$2,500 was a fixed fee received for a definite service, the performance of which was completed by the end of August of that year. There is no relationship between that \$2,500 and any future sum to be paid upon the litigation or for services rendered or to be rendered. It might just as well have been that I never would have seen Mr. Lang again after the time I handed him the complaint. He was under no obligation to return. We were under no obligation to see him if he did return.

There was discussion about our future employment if agreeable to the parties in France. I told him I thought he had a good case and if he came back and wanted to hire us, I certainly would like to talk to him. I desired to represent them and go forward because Mr. Lang told me how three different firms had turned him down. He asked me if I was afraid to sue Mr. Fleishhacker. That being some years ago, and being somewhat younger, I said, "The bigger they are, [65] the harder they fall, and we will take them to the Federal Court and see." I sent a copy of the proposed complaint to Pierre Le Paille, the French attorney who was

(Testimony of Harold C. Morton.)

advising them on that end. Mr. Lang undoubtedly may have submitted in some form to the other interests abroad some information regarding any contingent fee arrangement or the cost of litigation if filed. He and I discussed various arrangements, as I have said before. There was nothing in writing up to the time the matter was submitted abroad. As I remember, at one time I told him "We will take the case fifty-fifty and you don't have to put up anything." We had naturally in a case like that many discussions back and forth. There was no discussion at that time regarding the bringing of any kind of action in equity or at all with respect to any other matter except the matter in Kern County. There was discussion, as you know, from the agreement. You notice there is a 1911 transaction which is also mentioned on which suit was never brought, but that also was a Kern County transaction, although not the same land; another parcel of land.

Before the \$2,500 payment he had mentioned the fact that there had been a sale in 1911 which they were suspicious of, but the 1915 and the 1917 ones were the transactions which we were employed to draft the complaint on.

There was no written draft of any other proposed fee arrangement. They were discussed and I know we discussed [66] the question of a fifty-fifty arrangement where they wouldn't put up anything. That was when we discussed the entire matter, the very first time he came to me. He wanted to know

(Testimony of Harold C. Morton.)

how we would handle it. I said, "I don't know, I don't know enough about it." When I gave him the complaint, as he went on his way he said, "What about the arrangement?" I said, "We will talk about it when the time comes if you come back." When he came back we spent two or three days on fee discussion, and that I know was before we received the money. It was early in October. We didn't receive this money until the middle of October, the \$27,500.

There was no discussion regarding Mr. Lang or any of their interests putting up or advancing sums of money from time to time to cover costs of litigation, such as investigation and filing fee and so forth. Mr. Lang, when he came down when the fifty-fifty arrangement was discarded, Mr. Lang wanted a percentage arrangement plus an agreement as best we could reach that so much money would cover the expenses which they put up. And he wanted to know that it would be used for that purpose, with the understanding that what was left over would be ours.

Mr. Lang is in Southern California. He is engaged in oil operations on some of the family's properties in Kern County.

There was no estimate made of what these expenses [67] would run or what they would consist of except that I estimated that it might be \$20,000—it might be \$10,000, \$20,000 or \$30,000. There was no way of being exact.

As soon as the money was paid a certain amount

(Testimony of Harold C. Morton.)

was taken and used by the firm at that time. \$2,000 of that immediately and \$1,500.

We did not know that we would have to have that for expenses except for legal fees for ourselves. When Mr. Lang approved our taking that, it was with the understanding that it would be restored, and would be used because we were under the obligation to meet all expenses, even though the \$27,500 might be insufficient. That was pursuant to the agreement and the oral agreement as well. That was the understanding. Exhibits 10 and 11 are the only written contracts on the subject. It is true that there is no mention made of any trust accounts or funds to be maintained as such, but as I say, the \$27,500 was handed to us with that distinct understanding with Mr. Lang that it would be trust fund, would be so regarded and would be set up as such and from time to time he examined this trust account and was familiar with it.

Our running Lazard trust account, which would be Exhibit 5, was examined by Mr. Lang I am sure several times a year during its history. Probably one year it wasn't because there was one year when he was not here at all. I can't fix it exactly now. He was in France all of [68] one year, but otherwise every year he would go over matters, and we would discuss it with him. He was here working on the case almost constantly, except for that one period when he was in France for about a year. When I say here I mean in the United States. He was not in San Francisco most of the time after we



(Testimony of Harold C. Morton.)

started the lawsuit. He started his investigations in San Francisco.

I would say Mr. Lang was present personally and discussed with me on every occasion when any money was allocated to Hanna and Morton out of these funds. We never took money out of this trust account without his approval. Mr. Hanna was right here. Mr. Hanna was not present with Mr. Lang and myself when that was done. I am sure Mr. Hanna never handled these matters with Mr. Lang at all.

I did not discuss with Mr. Hanna anything about division of this and whether or not Mr. Lang's consent had to be secured. I am sure I advised Mr. Hanna that I had obtained Mr. Lang's consent to withdraw so many dollars from the trust account. I would be the one, with Mr. Lang's approval, to authorize any allocation from this trust account to Hanna and Morton. Mr. Hanna would have nothing to do with that. That approval was never in writing. Our firm did not render any statement of account to Mr. Lang or any of those interests regarding the exact status of this fund except that he saw this trust fund constantly, as I say. He may have had copies made of it. [69]

All kinds of expenditures over a period of many years on this litigation would be paid out of this account at my direction. That was just our firm account. Mr. Lang had nothing to do with it except it was kept with his knowledge and with his approval and his examination as well as ours. He

(Testimony of Harold C. Morton.)

was interested in the fact we were to use the funds for this purpose.

Between August 19, 1932 and 1940, I would say Mr. Lang looked at this account several times each year. It is difficult, perhaps, to understand, if you would know Mr. Lang you would understand he is a little fussy individual who was in everything all the time. And that is the reason our lawsuit was successful, because he is that kind of a person. He just goes into everything, and he knew that account better than I did.

Referring to Exhibit 3, the second item of funds expended is \$1,000 to myself. The next item is Byron C. Hanna, expense, \$1,000. Those are two checks written to us, Checks Nos. 348 and 349, each of \$1,000. When Mr. Hanna and I take money out of the firm, it is called "expense," and you will find that it is, or that that the same \$2,000 which is identified on Exhibit 5 at the corresponding time there.

Referring to August 19. That was simply withdrawal from the firm of what you might call partnership withdrawals, I guess, in August. In other words, Mr. Hanna and I got [70] \$2,500 on that day, and we each took \$1,000. That is out of the \$2,500 fee that we discussed a moment ago.

The daily financial report is a summary of all our receipts and disbursements for that date. Every check written and every amount received by the firm of Hanna and Morton appears on this current daily statement for that particular day. That is



(Testimony of Harold C. Morton.)

the way Mr. Hanna and I know what is going on; at least we hope we do.

That included fees of a general character as well as trust funds. You will notice how the trust fund is always segregated. When money comes in for trust purposes, there is a heading, "Trust" where the notation is made.

Referring to Exhibit 4 and to the item of Check No. 640 to the Bank of America for \$10,000, labeled "To Savings Account." We put \$20,000 of this \$27,500 that we received at that time in trust in two savings accounts because we realized we wouldn't be spending it all at once. We put it into savings accounts. That was a firm savings account under the name of Hanna and Morton. It was not labeled "trustee." I think we might have one now, one particular one, but none of our accounts were labeled "trustee." We carry trust funds in Hanna and Morton and show their trust character on our books.

The trust funds are shown on our records. It is a trust account for the clients and our daily reports and [71] our records show when funds are received in trust.

I believe that in addition to this savings account, our firm at the time had two commercial accounts, one in the Bank of America and the other in the Security Bank.

Referring to Exhibit 4, Check 641, payable to Security-First National Savings Account, \$10,000, I say we put \$20,000 in savings accounts: \$10,000 in

(Testimony of Harold C. Morton.)

the Bank of America and \$10,000 in the Security-First National Bank. That was done, as I said a moment ago, because we weren't going to spend all the money immediately, and with Scotch ancestry in me, and at that time it was not against the law for a partnership to have a savings account, which it is now. Mr. Lang knew about that. He watched those funds like a hawk. I don't believe Mr. Lang ever examined our daily reports, but he knew that \$20,000 of it was put in a savings account because I discussed it with him.

These sheets labeled "Lazard Matter" would not show the \$10,000 going out to each of those savings accounts. The account cards do not show the specific banking institutions in which the funds would be. That is shown on the daily reports. They do not show the two items of \$10,000 each, out. They would not because they didn't go out, so to speak. They were still in our bank accounts. The only items that would go on there would be if they went completely out of our affairs. Either Mr. Hanna or myself could draw on those two savings accounts.

[72]

I don't know whether counsel here has the savings account books or a transcript showing the complete entries of those accounts. I remember we had to close them out or something, and we couldn't have a savings account at some time.

Mr. Mackay: I have them both here.

We have the transcripts of accounts in each one of the banks. We have the transcript of the ac-

(Testimony of Harold C. Morton.)

count in the Bank of America and in the Security-First National Bank.

The transcript of the savings account with the Security-First National Bank of Los Angeles was marked Respondent's Exhibit A, and the transcript of the savings account with the Bank of America was marked Respondent's Exhibit B.

Exhibit A and Exhibit B were admitted in evidence.

Respondent's Exhibit A contains the following items:

(Security-First National Bank of Los Angeles  
7th and Grand Branch)

Hanna & Morton

Account No. 16855

Date	Withdrawn	Interest	Deposited	Balance
Oct. 15 '32			10,000.00	10,000.00
6/30/33 Int.			222.91	10,222.91
12/31/33 Int.			153.33	10,376.24
6/30/34 Int.			155.64	10,531.88
12/31/34 Int.			144.80	10,676.68
				[73]
Jan. 2 '35	676.68			10,000.00
6/30/35 Int.			125.00	10,125.00
12/31/35 Int.			101.25	10,226.25
Mar. 31 '36	10,226.25			

Respondent's Exhibit B contains the following items:

(Bank of America National Trust & Savings Assn.)

Transcript of Term Savings Account Transferred

From Los Angeles Main Branch (No. 600) 4-27 1944

To.....Branch (No. ....) for \$.....

Savings Account No. 4460 in the name of Hanna & Morton

Closed by your Collection No.....

(Testimony of Harold C. Morton.)

## Transcript of Account

Date	Withdrawn	Deposited	Balance
10-15-32		10,000.00	10,000.00
4-15-33	5,000.00		5,000.00
6-30-33	Int.	111.45	5,111.45
12-31-33	Int.	76.66	5,188.11
6-30-34	Int.	77.82	5,265.93
7-5-34	1,265.93		4,000.00
7-21-34	4,000.00		

Referring to Respondent's Exhibit A, that shows the first \$10,000 I have testified to. It shows interest credits, [74] the first one being for June 30, 1933, \$222.91, and then various other interest credits down under March 31, 1936. At the time I was familiar with that. The amounts withdrawn were transferred into our general accounts. I am inclined to think that is about the time that it became unlawful for a partnership to have a savings account. With reference to the withdrawal of interest in the aggregate amount of \$676.68 on January 2, 1935, we probably just withdrew the interest as such and put it in the general accounts. There was no division of the \$10,226.25 in 1936. I am sure that money was transferred into our general commercial accounts from out of the savings accounts.

Referring to Respondent's Exhibit B, that shows the initial \$10,000 that I have testified about. With reference to the withdrawal of \$5,000 on April 15, 1933, that was done simply because we were spending money chargeable against this trust account and wanted some of it in the commercial account on which the checks were being written. Mr. Lang did not have anything to do with the withdrawals

(Testimony of Harold C. Morton.)

from these savings accounts and the transfer to the commercial banks. He would have nothing to do with that. His concern was with the trust account as a whole. We didn't show the savings accounts to Mr. Lang. We told him that is what we were doing, that we were putting the money in savings accounts until such time as it would be [75] used.

With reference to the withdrawal of the final balance of \$4,000 in 1934 as shown on Exhibit B, that would go to the commercial accounts at that time. That was closing it out.

In 1934, prior to that time, \$1,265 had also been withdrawn and transferred to the commercial account.

These interest items were discussed with Mr. Lang. Mr. Lang said we could keep the interest and we could put it back if it was ever necessary to complete the payment of expenses, which was our obligation anyway, and I said, yes, that is what we would do.

I do not know whether anyone ever reported any of that interest received for income tax purposes, except Hanna and Morton have been reflected as the overall receipts of Mr. Hanna and myself. That is the only way it would be. I don't believe the French folks ever did. I say that, although I have never seen their returns.

Except as my discussions with Mr. Lang would be an account of it, there was no accounting made as to any of those interests as far as the bank interest items were concerned.



(Testimony of Harold C. Morton.)

Mr. Lang said, just as I said a moment ago. We were going to put this money in savings accounts to get some interest on it. He said, "You can take the interest if you are that careful," or something to that effect, [76] "if you will put it back in the bank if ever needed." If he had told us not to do it, we wouldn't have done it, that is a cinch. I do not think we could have done it, though. It was a trust fund, expressly understood to be such. Our only discretion was the necessary expenses in this litigation. Our firm was responsible for all expenses under the agreement even though they might exceed the trust funds. But our only discretion was I spend money where I thought it was necessary and proper out of this fund to promote this litigation. I discussed with Mr. Lang the placing of this money in the savings accounts when it went in, as I told you before. He thought that would be a good idea. The division was made as to two accounts just to put it in two different banks.

With respect to the difference between this control account and the other account that is reflected by the prior exhibits, the only thing of this same size, on this same size paper, you have the Lazard Matter account, which is Exhibit 5, then you have Exhibit 8, which is a control account of all our trust accounts of different clients. You see, we had various clients whose moneys we had in trust in and out with a running balance. Then when \$27,500 came in in October, you see it would increase that running balance of all our trust accounts. There is the



(Testimony of Harold C. Morton.)

case of Myers v. Texas Company. We had some [77] money in there, and so forth. Mr. Lang would not know about this control account. He would know about the particular trust fund which he was interested in. As we paid out expenses we charged it against the trust account. If I would pay \$37 to a Court Reporter for taking a little deposition, or \$100 to an appraiser for a report, why it was paid, our charge was written and it was charged against this trust fund. That would be reflected in this over-all account. It would be in Exhibit 5 which is headed, "Lazard Matter, Trust Account." For instance, here is an item to an engineer "Preparation of data and maps, Lost Hills, 156.25." It was paid and deducted from that card.

Referring to Exhibit 8, and to the item opposite October 15th, as to H.C.M. and B.C.H. Salary, Lazard, \$2,000, and October 31, charge, Lazard Matter, attorneys' fees, \$1,500, I do not know why that word "salary" was used, as I said before. Both items were payments to Mr. Hanna and myself, withdrawals for us, with Mr. Lang's approval, from these trust funds; hence they appear on Exhibit 8.

With respect to incidental costs of investigation and litigation. I don't know how thoroughly Mr. Lang checked Exhibit 5 from time to time. Of course, the principal items he would be familiar with because he was here with me most of the time. As I say, there was about a year when he wasn't here. I don't recall anything further about the [78] question of reporting interest received from this

(Testimony of Harold C. Morton.)

account by our firm as income of the firm. I would assume the firm reported it as interest received. We hire experts to prepare our firm's income tax returns and we sign them and make the auditors sign them, with a little notation that they are the ones who prepared the returns. I don't mind appearing in Court here representing clients in income tax matters, but I prefer to have an expert on my own.

I observe that on the 1932 income tax return of Hanna and Morton there is no interest reported for that year.

I observe that on the 1933 income tax return of Hanna and Morton an item entitled "Interest on Bank Deposits" and so forth \$780.19. I would presume that item should include some of the interest on those two savings accounts. I wouldn't specifically recall now. It may not have been because it may have been the interest was taken up in the year in which it was taken out. I don't know for sure.

The 1933 Partnership income tax return for Hanna and Morton was received in evidence as Respondent's Exhibit C. This exhibit contains the following entries among others:

1. Gross Receipts from Business or Profession .....	\$140,707.90
5. Interest on Bank Deposits, Notes, Corporation	
Bonds, etc. ....	780.19
	[79]
7. Rents .....	\$1,053.50
8. Royalties .....	1,680.57
9. (a) Profit from Sale of Stocks and	
Bonds held 2 years or less.....	1,235.21

(Testimony of Harold C. Morton.)

10. Dividends on stock of:		
(a) Domestic Corporations subject to Taxation under Title I of 1932 Act .....	347.50	
12. Total Income in Items 3 to 11.....		\$145,804.87
DEDUCTIONS		
13. Salaries of Employees .....	29,537.51	
14. Rent on Business Property .....	8,245.00	
15. Repairs .....	120.05	
16. Interest on Indebtedness .....	1,974.63	
17. Taxes paid .....	453.65	
20. Depreciation, Obsolescence, and Depletion .....	1,471.19	
21. Other Deductions Authorized by Law:		
Per Detail .....	8,316.38	
Donation, Amer. Red Cross, 25.00; L. A. News Boys Club, 5.00.....	30.00	
22. Total Deductions in Items 13 to 21		50,148.41
23. Net Income .....	\$ 95,656.46	

[80]

It does not contain any schedules showing the items comprising Item 5 of Gross Income.

The 1934 income tax return of Hanna and Morton shows an item of interest of \$741.56. As to whether that includes interest on those two savings accounts, I would have to answer in the same way as I did with respect to 1933.

The 1934 income tax return of Hanna and Morton was admitted in evidence as Respondent's Exhibit D. This income tax return contains among others the following items:

(Testimony of Harold C. Morton.)

## GROSS INCOME

1. Gross Receipts from Business or Profession .....	\$169,258.98	
5. Interest on Bank Deposits, Notes, Corporations Bonds, etc. ....	741.56	
7. Rents—Bungalow Court .....	1,116.54	
8. Royalties .....	2,721.21	
9. Capital Gain (or loss).....	3,386.85	
10. Dividends on Stock of:		
(a) Domestic Corporations subject to Taxation under Title I of 1934 Act .....	475.00	
12. Total Income in Items 3 to 11.....		\$177,700.14

## DEDUCTIONS

13. Salaries of Employees .....	\$ 36,072.56	
14. Rent on Business Property.....	8,807.50	
15. Repairs .....	210.70	
16. Interest on Indebtedness .....	1,125.65	
17. Taxes paid .....	372.36	
21. Depreciation .....	1,789.60	
22. Other Deductions Authorized by Law .....	8,506.99	
23. Total Deductions in Items 13 to 22.....	56,885.36	
24. Net Income .....		\$120,814.78

It does not contain any schedules showing the items comprising Item 5 of Gross Income.

The partnership income tax return for the calendar year 1935 of Hanna and Morton was received in evidence as respondent's Exhibit E. It shows an item of interest received reported as Item 5, of \$419.29.

I think during some of those years the Partnership owned some securities, but I, of course, don't

(Testimony of Harold C. Morton.)

remember what particular items would apply to what now.

The rule came out that a partnership couldn't have a savings account. I don't believe after that we had a savings account. I am quite sure neither Mr. Hanna nor I used individual accounts as a subterfuge to evade that regulation.

The 1936 income tax return of Hanna and Morton contains an interest item of only \$63.69.

In January 1933 the suit was filed over the 1915 and 1917 sales, that is what we call the Kern County suit, and that was the one, the history of which I previously gave. [82] That was the one we discussed about and prepared the draft of complaint on. That suit was filed as an equity suit to recover possession of the property and an accounting of the profits therefrom. In the course of the actual trial, the Trial Judge on the grounds of the Statute of Limitations only, ruled in favor of all defendants at the conclusion of my case, except the Anglo Bank and Herbert Fleishhacker. The other defendants had the property. That changed it to a law action, and by stipulation the case was transferred to the law side of the Court. A jury trial was waived. We continued on with the trial. That is the main case that was concluded and the same one on which the contingent fee was paid in 1940.

Outside of that one case there were discussions with the Lazard interests regarding the filing of other suits and the taking of other legal action. Some time after this employment in October of



(Testimony of Harold C. Morton.)

1932 a matter came up of certain members of the family who were still stockholders of the Anglo Bank in San Francisco, making a demand on the directors of that bank to proceed against Herbert Fleishhacker for an accounting of profits allegedly made by him in connection with certain transactions with parties by the name of Barde, in Portland. The facts in connection with that case came to light first in the investigation of the main case. That matter was first mentioned by the end of 1932. I believe it was in 1934 [83] that a suit actually was finally filed by some of the members of the family as stockholders, after demand and refusal of the directors of the bank to take proceedings. That for convenience is called the Blum case, or Barde case. It was filed in the Federal Court in San Francisco. Our only fee arrangement with respect to that was it being a minority stockholders suit, it was one in which if we were successful under recognized principles of law, the Court would award us fees to be paid out of the funds recovered in such action. That case was tried before Judge St. Sure in the middle of 1937. It was tried before the Kern County case. Some of the members of the family were plaintiffs, and there were some plaintiffs who were not involved in the Kern County case. We received a fee in that case at the end of that trial which was allowed by the Trial Judge because we were successful in recovery. In other words, that is what is called a stockholder's derivative suit. We were successful and the Judge allowed us a fee payable



(Testimony of Harold C. Morton.)

out of the recovery. We did not receive a fee from the clients as such.

We had counsel associated with us in that case. The Judge allowed us 10% of the recovery. His judgment, as I remember, was \$700,000. An appeal was taken. When the affirmance came back he allowed us an additional \$35,000. In the meantime, Fleishhacker had gone into bankruptcy and I believe it was in October of 1941 that we [84] finally received \$40,000 to cover that entire situation. That bankruptcy proceeding is still pending. We disposed of all of our claims for attorneys' fees and expenses to the Anglo Bank, a creditor of the bankrupt. Mr. Fleishhacker's bankruptcy proceeding was first filed at the end of 1938. He was not adjudicated until some time thereafter. At that time the Kern County case had been reduced to judgment and was on appeal to the Circuit Court of Appeals for the Ninth Circuit. It was the Barde case that precipitated the bankruptcy proceedings, because there was no stay of execution in that case.

In the Bankruptcy proceedings I made a motion for the appointment of a receiver. That must have been at the end of 1938, which was contested over a period of time and which resulted in the appointment of a receiver. We simply filed claims, and a receiver was appointed, and that was that. We followed it up as to the hearings. I still get notice of all the hearings. I don't attend them but I still get notice of them. The Bankruptcy proceeding is still pending.

(Testimony of Harold C. Morton.)

We had no fee arrangements with respect to the Lang interests regarding the filing of our claim in the Bankruptcy case. We just filed those claims as a matter of protection for these two judgments that we were interested in. We had to file the Kern County judgment claim. We filed a claim in behalf of the judgment which had been obtained in San [85] Francisco. You know the time for filing was fixed and we filed them. I don't know as we dealt with anybody on the protection of our judgment. As a lawyer I knew these claims should be filed and the matter should be watched and we did so. Subsequently Mr. Moore who was our associate and ourselves were allowed a fee by the Bankruptcy Court, payable out of the bankruptcy, for bringing about the appointment of a receiver. I think it was \$5,000.

Mr. Fleishhacker filed his Bankruptcy proceeding in 1938. He applied for the appointment of a creditors' committee or something. I came in and appeared and on behalf of these two judgments of these creditors made a motion for the appointment of a receiver. Several days were spent in evidence on that, with arguments on each side, and the receiver was appointed. Mr. Sterling Carr, of San Francisco, a well known lawyer, was appointed. Meantime our appeals were on their way up. This Kern County case was being appealed, as was the San Francisco case. The receivership was discussed with Mr. Lang. I don't think he was in the country at the time that the application was made. That bankruptcy proceeding was a very elaborate and

(Testimony of Harold C. Morton.)

complicated affair because of Mr. Fleishhacker's affairs, which had many ramifications, which I have not followed. We did not take an active part in it.

Some time in 1939, I believe it was, Mr. Fleishhacker [86] consented to an adjudication. I had nothing to do with it. I just know that it occurred. I don't think I ever attended a hearing in the Fleishhacker bankruptcy after we had the receiver appointed until an application was made by Mr. Moore and ourselves for an allowance of compensation out of the bankruptcy for having the receiver appointed. I can't fix that year for you but it was in 1939 or sometime subsequent. I would think it was 1940 or 1941. I could get that date for you. The bankruptcy continued through 1941 and has continued right down to date. The man who had been appointed receiver became trustee after the adjudication.

I believe it was in the month of October or September that we disposed of our claim. By "we," I mean Mr. Courtney Moore and our firm. Our claims for fees and expenses which had been allowed by the Court we sold to the Anglo Bank for a fixed sum and they stepped in in our place. They owned about five-sixths of the total claims in the bankruptcy anyway, and I guess were acquiring all of them, or were trying to. In other words, we didn't wait liquidation in the form of dividends to receive the fees allowed us. I did not keep in touch with that matter in 1942 or in 1943. In 1941 I did not discuss what action I had taken, as I have testified.

(Testimony of Harold C. Morton.)

That was none of his concern. I am sure I never discussed it with him. I saw Mr. Lang in 1941. He came to this country early in 1940 [87] and has been in this country continuously since. I had no discussion with Mr. Lang in 1941 regarding either the bankruptcy matter or any aspect of it or the Kern County litigation. The Kern County litigation was completed and finished and tied up and over with on January 19, 1940.

We did not receive any additional money from Mr. Lang or any of the Lazard interests after the receipt of this contingent fee in 1940 for any legal services rendered them, with the possibility that we probated some estates in Santa Barbara of certain deceased persons, and we might have received fees for those probate services after that date. We received nothing additional in the Kern County case.

Nothing further was received in connection with this Portland case after we received the contingent fee in 1940. The Portland fee was actually received in October of 1941, but there was no work done on that case after that time in 1941. I undoubtedly told Mr. Lang what happened but that would be all.

The Portland matters and the Kern County matters lapped over each other. I think the Portland case was filed in 1934. We had San Francisco counsel associated with us in that case, Mr. Courtney L. Moore of that city. There was still another case, which we called the Market Street case, which had substantially the same plaintiffs as the Kern



(Testimony of Harold C. Morton.)

County case. The facts of that case were discovered [88] during the course of working on the Kern County case. That was brought in the Federal Court in San Francisco. It involved the sale of a piece of property by the bank for these French folks in 1925, and we discovered that the bank, without bothering to tell the folks in France, had kept \$8,250 of the purchase price. I brought suit on that, I believe, in the latter part of 1934. That case was never tried. They paid off on that finally, without a trial. That was not handled under similar arrangements as the Kern County case. We discovered those facts, and I filed a suit, and the thing dragged along. We never discussed a fee arrangement. When they paid off, Mr. Lang and I discussed it and I think they had us retain a third of the recovery in that item. Mr. Moore of San Francisco was likewise associated with us in that case. They paid off in this case in 1938, following the other two trials. That case was on the calendar early in 1938, and instead of trying it they paid the amount of the demand, plus compound interest from the time of the take. We did not have a trust account for that litigation. We did not receive any money or initial retainer or for expenses in that case. Mr. Hanna did not have anything to do with that litigation except as I told him we brought the suit and what happened to it. It was our firm's action. In order to make that clear, Mr. Hanna and I perhaps have a peculiar partnership. This [89] is the fourth time in seven-

(Testimony of Harold C. Morton.)

teen years of law practice that he and I have gone to court together on the same matter. I came here as a witness in this case. We each handle particular cases or matters. Mr. Hanna paid no attention to the Lazard cases. Of course I would tell him of the developments. When he handled litigation, I might say to him, "What happened to such and such a case?" If it were over with, I would keep watching to see if the money came in. Our partnership is very unique. It is an equal partnership. Our only dispute is as to who gets to use our assistants because they are diminishing.

Our books and records are kept on a cash receipts and disbursements basis. We don't count it until we get it in. That is the system we had in the years from 1932 through 1940.

Some times during the period between 1934 and 1938 when I was discussing the Kern County litigation with Mr. Lang I would also discuss the Market Street case with him. As a matter of fact, he discovered the Market Street situation while we were in San Francisco together working on the Kern County case. I asked him what other sales had taken place, and he said there had been a sale of property in San Francisco in 1925 for \$150,000. I said, "How about it?" I said, "Go out to the Recorder's office. They have to put revenue stamps on the deed." He came back and said [90] \$165,000 of revenue stamps were on the deed. That led to the discovery. We had a definite agreement in



(Testimony of Harold C. Morton.)

writing with all the various people as shown by Exhibit 11 with respect to the Kern County litigation before we filed the action in the Market Street case, and long before we even knew there was a Market Street situation. The Market Street case was just a text book case. It was a text book case of fiduciary fraud. When they wanted to settle the case and offered me principal and interest, I refused to take it unless they compounded the interest, which they did. There is absolutely no relationship whatever insofar as any compensation is concerned between these two cases. There was no connection between them at all. The one was discovered while working on the other. A different fee arrangement was applied.

There was a good deal of discussion prior to arriving at the figure of 15% contingent rate. We visualized this might result in millions of dollars of recovery, as you can see by the reading of the contract. There were many discussions of percentages and finally we agreed upon 15% if they would put up the money to be used for the costs. It was also agreed that whatever might be left over at the end of the road would be fees.

I drafted Exhibits 10 and 11. I dictated them after consultation with Mr. Lang, with Mr. Lang present in the office. The first paragraph with a heading on the [91] first page is labeled, "Fees and Costs." The very next paragraph after that caption said "Clients will pay to the attorneys \$30,000. and a contingent fee." The actual facts were, as I

(Testimony of Harold C. Morton.)

have stated them—the actual agreement is as I have said. On the top of the next page there is a paragraph: “Said attorneys agree in consideration thereof they will bear and pay all expenses and costs of such suit or suits, and hold the clients harmless by reason thereof.” We agreed to do that in consideration of them putting up the \$27,500. There is a separate paragraph dealing with expenses and costs, and that says that we agree to pay them. The language of the document is that that is in consideration of their payment of \$30,000 as shown by the prior paragraph. That is exactly not what was agreed upon. The \$30,000 was put in there because Mr. Lang wanted the \$30,000 recited, as I said before. He did not pay this \$30,000 as a fee or any other amount as a fee, except as previously we had been paid \$2,500 for an isolated service. The other amount, which would make the total of \$30,000 was the \$27,500, which it was expressly agreed would be in trust and we would receive as a fee that which might be left over at the end of the litigation. I am giving you the true consideration for this agreement, the one which was discussed and the actual understanding between the parties. It was because of that that the money was set up in trust. [92]

We didn't take the \$30,000. We did take money out. We took money out of it on certain instances as I have stated, with Mr. Lang's approval on each. Mr. Lang cared whether we took it out or not. I

(Testimony of Harold C. Morton.)

wanted to take more than we did in October of the next year.

These records are control records and the Lazard trust records certainly are internal records of our office. They are records which we kept of our business transactions. We think there was a separate trust fund set aside in the usual sense of a trust. We think when we earmark these things and show our balance to be only that which is left after deducting the costs, we have done that. We did not render a written statement to Mr. Lang or any of these people regarding the exact status of that account, except Mr. Lang had access to Exhibit 5 at all times, as I have testified. He may have taken abstracts of this off.

I did not attempt to allocate my income taxes back under Section 107. Mine was an entirely different situation. I have some rather extensive business interests outside and it made no difference in my tax situation. It couldn't have made much difference, or it would have been allocated over the years. [93]

### Redirect Examination

The judgment in the Kern County case was against the Anglo Bank and Herbert Fleishhacker. It was fully satisfied January 19, 1940.

Thereupon the further trial of the case was adjourned until April 28, 1944 at 10 o'clock a. m.

At that latter time the redirect examination of Mr. Morton was resumed as follows:

(Testimony of Harold C. Morton.)

After the Kern County case was finally settled and we had received the fee to which I testified yesterday, we paid to one of the men in our office, one of the men employed by us, the sum of \$5,000. That was Leon Brown. Mr. Lang and I, jointly, he out of his own affairs, or his family's affairs, and ourselves, together, paid Mr. Ben Dudley \$3,000. We wrote the check and Mr. Lang reimbursed us for half of it. The effect was that our firm paid \$1,500 to Mr. Dudley. These two payments were made after the matter was completed.

#### Recross Examination

With reference to a payment to Mr. Dudley, we wrote the check for \$3,000, and I remember cashing it for Mr. Dudley, because when I told him we were going to let him have it he asked if he could have it in cash. Then Mr. Lang reimbursed us for half of the \$3,000. Mr. Brown was not a [94] member of the firm. Mr. Brown, like a number of other lawyers we had employed with us, was employed on a basis—we paid him a salary, so much a month, and it has been our practice over the years when one of the employees in the office worked on a particular case, when that case it over, we give him a check. You might call it a bonus, or what have you. In this case, after it was over Mr. Hanna and I discussed the matter and decided to give Mr. Brown \$5,000. Mr. Brown worked on the Kern County case. He attended the trials of the Kern County case and assisted me on that case. He may have worked incidentally in our office in connection with other mat-

(Testimony of Harold C. Morton.)

ters for or on behalf of the Lazard interests, but not particularly.

In response to a question as to whether the witness recalls as to whether Mr. Brown had anything to do with any income tax matters of Francois Lang and others of the Lang interests in connection with a question of deductions for legal expenses, the witness stated there has been some tax litigation arising out of that recovery going on ever since the recovery. I had only known of it sort of remotely. I think Mr. Brown was in it from the beginning, and while he is no longer with our firm, I think that litigation was finally disposed of here, if I am not wrong, sometime within the past several months. It would be my recollection that it was concluded within recent months. I couldn't tell you definitely. I could not recall by [95] citation whether that is the case of Francois Lang, 45 BTA-256. Show me the book and I am sure I will be able to see if there is anything in there I can identify.

Whereupon the witness was shown the volume and then testified: I am sure it is the same Mr. Brown we were talking about, and this is undoubtedly that proceeding before the Tax Court, which was then known as the Board of Tax Appeals. I suppose you could say the firm of Hanna and Morton to some extent was in that case. Mr. Brown handled the matter. I think it went to the Circuit Court of Appeals after that.

Whereupon counsel for Commissioner presented to the witness a document purporting to be a mimeo-



(Testimony of Harold C. Morton.)

graphed copy of a certain stipulation of facts, which was marked Exhibit F for Identification. The witness proceeded to testify as follows:

I would imagine that either Mr. Hanna or myself may have been counsel in this case sometime. I noted in the beginning of this case it only refers to Mr. Brown. Exhibit F for identification contains my name and also Mr. Hanna's name and Mr. Brown's is the third name. There are three typewritten names, Hanna, Morton and Brown; and the typewritten signatures by Leon B. Brown, and that is Mr. Brown's signature. Mr. Brown signed it in connection with that case. It is also signed by counsel for the Respondent in that case. The item of \$30,000 at the bottom [96] of page 11 must have been the \$30,000 which has been referred to in the subject Hanna case.

The Respondent's Exhibit F for Identification was received in evidence as Respondent's Exhibit F. In so far as material here it may be described as follows:

It is a stipulation entitled, "In the United States Board of Tax Appeals" and bearing the title of nineteen proceedings before the said Board of Tax Appeals, Docket No. 102740 to 102758, inclusive, the first of which is Francois Lang, Petitioner, v. Commissioner of Internal Revenue. It stipulates certain facts with respect to the Kern County litigation and the realization therefrom as effecting the income tax liability of the petitioners in these various proceedings. After referring to the recov-



(Testimony of Harold C. Morton.)

ery of judgment in the Kern County case it proceeds with the following language:

“6. On January 19, 1940, the full amount of said judgment, together with interest thereon in the sum of \$92,644.93, or a total of \$743,925.60, exclusive of taxable costs, was received by the above-named petitioners from counsel for the Bank and Fleishhacker in satisfaction of said judgment.

7. The attorneys for the above-named petitioners in said proceedings were entitled, under a contingent fee contract, to 15% of any recovery obtained by theme in said proceedings. On January [97] 19, 1940, the above-named petitioners paid to said attorneys, for their services in said proceedings, the sum of \$111,588.84, \* \* \*

8. Between April 1, 1931 and January 1, 1939, the above-named petitioners expended various sums totalling \$150,000, which expenditures were in addition to sums for which recovery was had as taxable costs in the proceedings referred to. \* \* \* Said amounts were expended as follows: \* \* \*

\$30,000 Paid to Hanna and Morton, attorneys for the above-named petitioners in the said proceedings, as retainer fees: \$2,500 of which was paid September 2, 1932, and \$27,500 on October 12, 1932;

\* \* \*

Dated this 20th day of February, 1941.

BYRON C. HANNA

HAROLD C. MORTON

LEON B. BROWN

(Testimony of Harold C. Morton.)

By LEON B. BROWN

Counsel for Petitioners

J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue,

Counsel for Respondent

Of Counsel: [98] ?

ALVA C. BAIRD,

Division Counsel;

FRANK T. HORNER,

HARRY R. HORROW,

Special Attorneys,

Bureau of Internal Revenue."

The witness proceeded to testify as follows:

The \$30,000 item mentioned in that stipulation must be the same dollars and cents that is involved in the subject case. Of course it is an erroneous statement, as you know from my testimony yesterday. I might say I have never seen this document before or the original of it before. I had nothing to do with its preparation. I did not know whether or not the Lazard interests treated the \$30,000 as legal fees or retainer. I never prepared any of their returns or never saw any of them. a

It was stipulated that the reported decision, Francois Lang, 45 BTA-256 may be considered as a part of the record in the present case for reference purposes, with the reservation that such stipu-

(Testimony of Harold C. Morton.)

lation should not be considered as a stipulation of any of the facts in that proceeding.

As to whether there was any connection between the Oregon litigation and the Kern County litigation, I suppose it would depend upon what you mean by "connection." As I told you yesterday, the facts regarding that Portland [99] case—we will call it that for convenience—the first facts were discovered during the work on the Kern County case. The Oregon litigation was the Blum case. My best recollection would be that it was filed in 1934. When those facts came to my attention, I associated San Francisco counsel with me. That was, as I explained yesterday, a stockholders' derivative proceedings where on behalf of certain stockholders we made demands on the bank to sue Fleishhacker, and when the Board of Directors ignored that demand, then we brought suit. That suit was brought in the Federal Court in San Francisco. It was tried in San Francisco in the summer of 1937.

In October of 1941, a check for forty some thousand dollars was received from the Anglo Bank purchasing all the interest that Courtney Moore and ourselves had, and the fees which had theretofore been allowed to us by the Court. I don't have the exact figure in front of me, but approximately \$20,000 of that was received by Mr. Moore, and something over \$20,000 by ourselves. I could get you the exact figure.

In the Market Street case, when we received a check on that, which was in the early part of 1938,

(Testimony of Harold C. Morton.)

we received a third of the amount. The \$8,250 principal sum with compound interest, amounted to approximately \$19,000 when the check was written. Our firm received slightly more than \$6,000 in that case as a legal fee; one-third in [100] in that particular matter.

Referring to ledger card 852, being Petitioner's Exhibit 6, I observe entries in the center of the page referring to Morton's trip to Portland and so forth. That referred to the Blum case. There were some items of expense in connection with the Blum case paid out of these funds with Mr. Lang's consent, with the understanding that those funds were reimbursable to this particular trust fund when and as that might become necessary. There are a number of items here that if I looked at, I could probably identify as Blum matters. The items were reimbursable by Hanna and Morton. In bringing this stockholders' derivative suit we knew that if we were correct and were successful our expenses and fees would be allowed by the Court out of the funds recovered. As in all litigation, expenses were incurred as we went along. I took the matter up specifically with Mr. Lang and secured his consent to use some of these trust funds for that purpose, with the understanding that we would restore them here when and as it became necessary to do so to complete the Kern County case. We also regarded these as borrowings from this trust account, with the consent of the client. Mr. Lang did not give us any new money to cover Oregon expenses. When that suit

(Testimony of Harold C. Morton.)

was started and I knew there were going to be expenses I took the matter up with Mr. Lang that there would be expenses. We discussed the matter and [101] I asked permission to use funds from this trust, from the \$27,500, for that case, with the understanding they would be returnable to make up this fund as it became necessary to do so. Our firm and the parties did not consider that that was covered by the two written agreements, Exhibits 10 and 11. The written agreements only covered the lawsuits they referred to. There were no other separate or similar agreements relating to this other litigation. As far as fees were concerned in the Blum case, that was a matter in which we could only get a fee such as the Court might award us if we were successful in that litigation. In other words, there was no fee agreed to be paid by the nominal clients, the plaintiff stockholders who were named as plaintiffs in the suit.

Referring to Petitioner's Exhibits 7, items referring to the Blum case are rather easily picked out. You will notice Portland mentioned. You will see from the Marshal at Portland, which would be a refund in connection with some service fee, I would assume, or something of that kind. They probably took a deposition up there. You probably would find in some places some traveling expenses, possibly mine, because I remember going to Portland on a couple of occasions in connection with this matter.



(Testimony of Harold C. Merton.)

With reference to the item, on October 31, [102] "Trans. from Trust-fee, \$1,000.00," with a "P" after it, the "P" doesn't mean anything. That is the \$1,000.00 I testified to yesterday we withdrew at the time. That does not relate to the Portland matter. That would be Kern County. We had no fees or anything you could call fees on the Portland matter until finally we disposed of our interests and fees which had been awarded, by the sale thereof to the Anglo Bank, as I have testified to. Many of the expenses came out of this Lazard trust account. The reference to a case of Dido versus House in Kern County, appearing on Exhibit 7, is part of our Kern County litigation. It is a long story. It has to do with establishing some title. We took a deposition up there.

Referring to Exhibit 8, the first item is the Lazard matter. You will observe here that it is the \$27,500 which is the credit here. Then crowded in under that is the \$2,000 which we withdrew from the trust account at that time with Lang's consent. As I said yesterday, I don't know why the word "Salary" was put there. The items are rather crowded together.

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Whereupon,

BYRON C. HANNA

was called as a witness by and on behalf of the Petitioner; and having been first duly sworn, was examined and testified as follows: [103]



(Testimony of Byron C. Hanna.)

Direct Examination

I am the law partner of Mr. Morton who just testified. Mrs. Hanna and I were married July 16, 1916 and have been ever since. I have resided in California, in Los Angeles, for over fifty years.

I handled the satisfaction of judgment that was obtained by the Lazards against the the Anglo Bank and Fleishhacker in 1940. On January 19, 1940, the satisfaction was made in open court. The Anglo Bank paid the judgment, and at that time paid \$746,354.95, for which I received a check in open court and satisfied the judgment in open court. The firm of Hanna and Morton received \$114,018.19 out of that amount. That was on the 15% contingent fee and reimbursement of some costs which we had expended from this trust fund and which were taxable as costs and recovered in the judgment. The amount of the costs was \$2,429.35 and the 15% contingent fee amounted to \$111,588.84, making a total which we received on that date of \$114,018.19. That was on January 19, 1940, and that is when our services were concluded.

The firm of Hanna and Morton kept daily financial records, showing receipts and disbursements. Whenever money was received for specific purposes, it was designated as a "Trust". We maintained a system under which we had each day a daily statement of cash received showing whether it was for trust account or for our own account. The daily [104] statement contained the expenditures for the

(Testimony of Byron C. Hanna.)

day, showing whether it was from our own account or from trust account; showed the balance of trust obligations, the balance in the bank and the net amount which belonged to the firm of Hanna and Morton. During the period from 1932 to 1940 the amount kept in our various bank accounts equalled or exceeded the amounts charged up in the trust accounts.

### Cross Examination

The original firm name was Fredericks, Hanna and Morton. That was J. D. Fredericks, Sr. Subsequently he retired—it was long before this—and his son, J. D. Fredericks, Jr., became a member of the firm with Mr. Morton and myself, and we carried on the old name of Fredericks, Hanna and Morton until June, 1932, when Mr. Fredericks, Jr. retired from that firm; and at all times subsequent to that the firm has been Hanna and Morton. I am the oldest member of the firm.

I am familiar, in a general way, with the Lazard litigation. I did not personally handle the matter. In our office our work is principally trial work. Mr. Morton handles cases that come to him, and I handle cases that come to me. I think the only appearances I made in connection with the cases that Mr. Morton testified about was when I went up and satisfied the judgment and collected [105] the money. That is in the Federal Court in the Kern County case. I did not appear in court at any time in connection with any other cases, but perhaps at

(Testimony of Byron C. Hanna.)

times we would confer in the office or consult about questions of law or policy to be pursued, but these were very infrequent occasions. I do not have a definite recollection of any particular occasion when there was such a conference in connection with the Blum case, but my best recollection is there may have been occasions when we did. I knew that Mr. Morton was actively engaged in the Blum case at Portland. Mr. Morton and I were equal partners. We were interested in the work that the other partner was doing, and naturally we would discuss that progress. I knew that the Blum case was part of the firm's business. I knew about the Market Street litigation in San Francisco when it was going on. I had a general knowledge of it. So far as I recall, the dates and figures that Mr. Morton testified to are substantially accurate, but I have no recollection of those dates or figures. I have no recollection of any different dates or figures. So far as my recollection goes, the dates and amounts which Mr. Morton testified to with respect to the Blum case at Portland, are substantially correct. I do not recall anything differently about those dates or amounts.

Our firm records were kept on the accounting basis of cash receipts and disbursements, with some modifications, [106] I believe. I am not an expert accountant, but I think there were some modifica-

(Testimony of Byron C. Hanna.)

tions, when, for instance, I think we deducted depreciation on our library and office equipment and so on. And there have been some minor items of that kind that were not on a strict cash and disbursement basis.

With respect to receipts or retainers during the years 1932 to 1940, we did not accrue any proposed fees in advance of actual receipts. When we would receive money to pay expenses, we would set it up in our trust fund.

The Lazard trust record which is in evidence, as shown by Exhibits 5 through 9, originally referred only to the Kern County matter. Our bookkeeping system was quite informal, and Mr. Morton and I were both very busy and didn't have much opportunity to supervise it on occasions, and it happened that when we started with one employment and another employment would arise, the whole thing would be carried along in one account until some occasion arose for segregating it.

The card numbers on Exhibits 6, 7, 8 and 9 have no significance. The ledger sheets had a printed number, consecutive number on them, but we did not keep track of those printed numbers. We just used the sheets when occasion arose. As to matters under the Lazard Trust captions, those were not all limited to any particular case, as far [107] as expenses and charges were concerned. Mr. Morton, I think as explained, and I can only add the same information, that there were items of expenses in this Lazard Matter trust account, Exhibits 6 and 7, which

(Testimony of Byron C. Hanna.)

related to the Portland case and I think maybe one or two that related to the Market Street case.

Originally there was no maintenance of separate sets of records in our office for the various suits that our firm filed for and on behalf of the Lazard interests. It was all run through one account. There was a maintenance of the trust funds, of course, at all times. Then later it was segregated into different accounts relating to different employments. We had a record of the trust money that came in, and we had a record of the trust money that was expended on the Kern County case and we had a record of the trust money that was borrowed to be used on the Market Street case and the Portland case. Not a segregated record. The trust funds were segregated. I will show you a record that is available in the court room, showing that the money was actually set aside as money. We have produced here Exhibit 4, which shows on the financial statement of October 15th that the entire \$27,500 was placed in trust. The money was all carried in the general bank accounts, which has been our policy and practice for many years. But we carried on our own records a designation of the trust funds. [108] It was to reflect the fact on our own records that these were not our moneys.

I had nothing to do with the drafting of the agreements, Exhibits 10 and 11, but Mr. Morton and I discussed various terms under which we might undertake this employment. I think that the agreements do not correctly show the consideration that



(Testimony of Byron C. Hanna.)

was received. As to the \$2,500, there was never any discussion about that. That was a fee for work that was done prior to—I think that work was terminated about the 31st of August, 1932, and at the conclusion of that work there was no continuing relationship between the clients and ourselves. We were dealing with some clients who were across the seas and beyond the reach of the country through agents who had a power of attorney to represent them. Exhibit 11 was signed, as it shows on its face. Exhibit 11 does not correctly express the consideration.

With reference to the Francois Lang and related taxpayers' income tax cases, I think the only extent to which I participated in that litigation was that I was present in the Circuit Court of Appeals when it was argued. I believe that this is the case that went to the Circuit Court of Appeals and I discussed with Mr. Leon Brown, who argued this, some of the legal questions involved prior to the argument, and counseled with him about the presentation of the case. [109]

Mr. Brown did not discuss the handling of the case with me with respect to a submission on a stipulation of facts while it was going on in the United States Board of Tax Appeals, except in a general way. We knew we had a case involving the questions of the income tax of these people, but Mr. Brown was handling it.

I am sure that when I prepared my income tax report for 1940, I did not check at all with the Lang



(Testimony of Byron C. Hanna.)

case and the stipulated facts there, which were filed on February 20, 1941. I am sure at that time that I was not cognizant of that stipulation, and I would like to add this further explanation: That this item of \$30,000 that has been referred to was merely treated by the clients as a deduction incident to the litigation. Mr. Brown did not ever bring that to my attention. Mr. Lyons did not discuss it with me. Whether it had been for costs or trust or what it had been for was immaterial in 1941. The clients were out in 1941 the \$30,000. There was no materiality at that time as to the circumstances or conditions under which they expended the money. They had actually expended it in connection with the work that was done, first preliminarily and later in connection with the litigation.

Referring to my testimony that at the conclusion of the Kern County litigation we received out of it the sum of \$114,018.19, and Mr. Morton's testimony to a figure [110] of \$121,700, I didn't testify to the same question that was asked Mr. Morton. I said that we received \$114,018.19 out of the recovery on January 19, 1940. We also had in the trust account at that time \$7,769.55, which was released to us, and that makes a total of \$121,787.74 received in 1940. The amount that we received out of the judgment in cash on January 19, 1940, was \$114,018.19, and we were then holding under the obligation of a trust \$7,769.55. We were released from that obligation, and that gave us a total recovery in 1940 of \$121,787.74.

There was something relating to the obligation

(Testimony of Byron C. Hanna.)

which I say we had, except Exhibits 10 and 11 in evidence. Mr. Morton has testified to it. It was my understanding that \$27,500 was given to us to use for costs in that litigation upon the condition if there was any of it left it would belong to our firm. I think at the end of the year closing entries were made relating to the release of that \$7,769.55 and the amount was closed out into our general funds. That is my understanding. Mr. Lyons is our accountant and looks after those matters.

The \$7,769.55 was reported in the year 1940 for federal income tax purposes. This is the Income Tax Return of Hanna and Morton for 1940. There is a memorandum attached which reads: "The income reported here includes a fee in the amount of \$115,287.74." That refers to the Kern County litigation fee, but the return also includes, as I [111] understand it, the sum of \$7,769.55. I think it is included in Item No. 1, Gross Receipts from Business or Profession. It is not separately shown.

Thereupon, the Income Tax Return of Hanna and Morton for the year 1940 was received in evidence as Respondent's Exhibit G. This exhibit, in so far as material, is as follows:

"GROSS INCOME

1. Gross receipts from business or profession .....	\$209,087.73
5. Interest on bank deposits, notes, corporation bonds, etc. ....	52.50
9. Royalties .....	973.07
<hr/>	
13. Total Income in Items 3 to 12.....	\$210,113.30

(Testimony of Byron C. Hanna.)

# DEDUCTIONS

14. Salaries and wages .....	29,925.30
15. Rent .....	7,565.00
16. Repairs .....	220.83
17. Interest on indebtedness .....	60.68
18. Taxes .....	1,286.22
21. Depreciation .....	882.06
23. Other deductions authorized by law .....	6,917.00
<hr/>	
24. Total Deductions in Items 14 to 23 .....	46,857.09
<hr/>	
25. Ordinary Net Income .....	\$163,256.21''

“Memorandum. The income reported herein includes a [112] fee in the amount of \$115,287.74 originating as the result of employment contract made in 1932, as to which one of the partners is retiring under the provisions of Section 107.”

There was no further checking with Mr. Lang or any conversation with him regarding the treatment of that last figure of seven thousand odd dollars, to my knowledge. There was no occasion for such under our arrangement. Under our arrangement it belonged to us. We took it over.

It isn't correct that after the agreements, Petitioner's Exhibits 10 and 11, were signed, that the members of our firm could handle the \$30,000 and particularly the \$27,500 in any way we wished as far as the actual handling of the cash was concerned any more so than any other trustee. I assume that any trustee holding trust funds can select the bank where they are to be deposited or possibly the permissible investments under the law in which they may be invested. I did not participate in any of the discussions Mr. Morton testified about that were had with Mr. Lang. I did not personally know of

(Testimony of Byron C. Hanna.)

any arrangements with Mr. Lang to hold any funds in trust for the purposes that were testified about only as I knew through discussions Mr. Morton and I had, and I know that definitely our discussion was that this money was trust money. [113]

The only discussions I know of were those that have been testified to. I do know that this money was paid to us to be utilized for the payment of costs in this case, and the balance, if any, to be our property at the time that the work was completed. I know it was treated as trust funds and regarded as trust funds at all times.

With reference to any other basis of advancing moneys by the Lazard interests in connection with the signing of the agreements, Exhibits 10 and 11, I know Mr. Morton and I discussed two proposals that I recollect. One of the proposals was that we would undertake the litigation on a 50-50 basis and we would advance the costs. Then we discussed the proposal which was finally accepted. We estimated as nearly as we could what the probable cost would be. We concluded if the clients advanced the costs, which we estimated to be \$27,500, that we would take the case on a smaller contingent fee basis. We were particular to see that the amount was as near as we could estimate it adequate to cover the cost of expenditures that might be incurred. But we did not limit our obligation to that amount.

None of these estimates were reduced to writing as far as anticipated costs were concerned. They

(Testimony of Byron C. Hanna.)

were verbal. These agreements were not after October, 1932. The first agreement that bears Mr. Lang's initials, that was initialled at the time we received the \$27,500. [114]

There were \$2,500 received August 19, 1932, for work which was done and completed about the end of August, 1932. Exhibit 10 was the one that was initialled by Mr. Lang and delivered to us at the time we received the \$27,500. The heading immediately preceding the item of \$30,000 relates not to a single paragraph but to a section of the agreement which consists of three paragraphs, Fees and Costs. At that time it was contemplated that this agreement would be sent to France for execution by the various parties. Mr. Lang said rather than have two documents go forward to show his accounting for the \$2,500 and the \$27,500, he would like to have this document recite \$30,000.

### Redirect Examination

Referring to Exhibit 2, which is a receipt reading, "Received Lazard Matter the sum of \$27,500.00 on account, trust account.", there is one thing that we are very particular about. When the money is trust money, it is always identified as such. We had a triplicate receipt book that each member of the firm had. Mr. Morton didn't use his. When he would get in money he would simply take the check to the bookkeeper and tell her to write the receipt. In this instance this receipt was written by the bookkeeper. He told her evidently that this \$27,500 was to be



(Testimony of Byron C. Hanna.)

placed in trust, and she noted that on the receipt, which is the carbon copy which she used [115] in making her cash records. The original goes to the client. The first carbon is appended to the deposit slip where the money is deposited in the bank. I assume Mr. Lang got that receipt at that time.

I have my income tax returns for 1932 to 1940, inclusive, and I have the revenue agent's report where examinations have been made. These files contain the income tax returns, copies of the income tax returns of Mrs. Hanna and myself, and reports of revenue agents' examinations for the years 1932 to 1939, inclusive.

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Whereupon

EDGAR P. LYONS

was called as a witness by and on behalf of the Petitioner; and having been first duly sworn, was examined, and testified as follows:

#### Direct Examination

I am a certified public accountant and have been such since 1925, and am practicing here in Los Angeles.

I have been employed by the firm of Hanna and Morton for some years to examine their books of accounts and records, and in the preparation of income tax returns, and also in some cases in resisting the claims of the Federal Government for additional taxes.



(Testimony of Edgar P. Lyons.)

This summary you have given to me was prepared by me from the Lazard trust card and relates to the entries thereon which have to do with the Kern County case. This was prepared from the trust card part of which is in evidence. [116]

Thereupon, upon request, Counsel for Respondent was permitted to cross-examine the witness at this point.

### Cross-Examination

With respect to this summary, these are costs for the Kern County litigation, costs incurred year by year for various types of expenses, traveling expenses and various types. The Lazard trust card was very carefully gone over by Mr. Leon B. Brown, who has been referred to, who marked on the card the items with respect to the Kern County case, as well as the items of expense with respect to the other cases which have been commented upon. This distribution, then, for the Kern County case, is made on the basis of Mr. Brown's identification of items. I think there were several items on the same record regarding the Market Street case in San Francisco in a couple of years. There were also expense items, some of them quite numerous, with respect to the Blum case at Portland. They were so identified on the card by Mr. Brown. I did not have anything to do with the keeping of these records contemporaneously during these years 1932 on down through 1940. I just made this summary later. The items under the column, "Firm Withdrawals" are based upon sums paid to Mr. Hanna

(Testimony of Edgar P. Lyons.)

and Mr. Morton and charged to the account. That was the payment of October 15th, I believe it was, 1932, of \$1,000 each. The rest of the items making up the total of \$5,500 are journal transfers, thereby reducing the balance on the [117] on the trust card and transferring these sums into the income account of the firm. They were transferred into the firm's income account, and taken up in income in the years in which entry was made.

Thereupon the summary was received in evidence as Petitioner's Exhibit 12. That exhibit is in words and figures as follows:

"STATEMENT SHOWING CASH RECEIVED, COSTS PAID, FIRM WITHDRAWALS AND BALANCE ANNUALLY 1932 TO 1940, RELATING TO KERN COUNTY CASE IN LAZARD TRUST ACCOUNT"

Year	Receipts	Cost Paid	Firm Withdrawals	Balance End
1932	\$27,500	\$ 609.28	\$ 3,500.00	\$23,390.72
1933		972.30	1,000.00	21,418.42
1934		4,559.67	.	16,858.75
1935		276.18		16,582.57
1936		186.23	1,000.00	15,396.34
1937		5,948.53		9,447.81
1938		1,060.69		8,387.12
1939		606.88		7,780.24
1940		10.69		7,769.55
<hr/>				
	\$27,500.00	\$14,230.45	\$ 5,500.00"	

Direct Examination Resumed

Mr. Leon Brown made these designations, I think, in 1940.

At that time Mr. Mackay announced that all of the [118] records of Hanna and Morton are present

(Testimony of Edgar P. Lyons.)

in the court room, and that if there is any desire on the part of Mr. Crouter to go into the original records, they are here.

Thereupon, the Income Tax Return of Byron C. Hanna for the year 1940 was received in evidence as Petitioner's Exhibit 13. That Exhibit 13, in so far as material, contains the following data:

INCOME

2. Dividends— $\frac{1}{2}$ to Spouse .....	\$ 262.50
6. Income from partnerships, etc.	
Per Schedule .....	11,992.12
8. Rents and Royalties .....	715.64
11. Other income .....	1,748.85
<hr/>	
12. Total Income in Items 1 to 11.....	\$ 14,719.11

DEDUCTIONS

13. Contributions paid .....	\$ 417.50
14. Interest .....	622.16
15. Taxes .....	955.66
18. Other deductions authorized by law .....	1,104.99
<hr/>	
19. Total Deductions in Items 13 to 18 .....	3,100.31
<hr/>	
20. Net Income .....	\$ 11,618.80

[119]

Application of Section 107—Lazard Fee

The relevant facts are stated as follows:

(1) Negotiations were started in July 1932 with Etienne Lang, acting for clients. On August 14, 1932 he made payment of \$2,500.

(2) This was accepted by the firm and paid as a fee for preliminary investigation of the case, and on the same day divided by the partners as a fee earned. Prior to verbal contract of acceptance, Mr.

(Testimony of Edgar P. Lyons.)

Lang continued to investigate the firm but was not obligated to consummate the matter. The firm, on the other hand, used the interim to weigh the possibilities of successfully conducting the case.

(3) On October 15, 1932, payment of \$27,500.00 was made by the clients pursuant to the terms of employment contract which was not fully executed until July 1933. However, on that date the terms set forth in the contract were verbally agreed upon.

(4) Contract provisions relative to fees are stated as follows:

“The clients will pay to the attorneys the sum of \$30,000 and a contingent fee based on the amount of all sums or things of value recovered as a result of such suit (or suits) of 15% of the first million dollars recovered and 10% of all sums in excess of one million dollars payable only when and as received by [120] the clients and in the same money or things of value as received by the clients. Of said \$30,000 the attorneys have heretofore been paid \$2,500.00 and the balance of \$27,500.00 will be paid forthwith upon the execution of this agreement.

“The said attorneys agree that in consideration thereof they will bear and pay all expenses and costs of such suit (or suits) including all appeals and hold the clients harmless by reason thereof.”

(5) The case was prepared, litigated, and judgment obtained, which was paid in the year 1940, and the contingent fee collected. During this interim all costs, which were paid by the firm, were charged to the “trust card” or account, on which had been credited the sums received from the client.

(Testimony of Edgar P. Lyons.)

(6) Summary of fees and expenses are shown as follows:

Aug. 14, 1932 Fee .....	\$2,500.00
Aug. 14, 1932 Taken by partners.....	2,500.00
	<hr/>
Oct. 15, 1932 Contract Payment .....	\$ 27,500.00
1932 to 1940 Costs, expenses, etc.....	14,230.45
	<hr/>
Balance in Trust.....	\$ 13,269.55
	[121]
Contingent Fee, Interest, etc. Received in 1940.....	114,018.19
	<hr/>
	\$127,287.74
Less: Fee Participations to other lawyers.....	6,500.00
	<hr/>
Net Fee.....	\$120,787.74
Less: Sums taken from trust account to General Ac- in 1932-3-6 by partners and returned as income....	5,500.00
	<hr/>
Portion Unreported.....	\$115,287.74
	<hr/> <hr/>

(7) It is the opinion of the taxpayer that:

(a) The original \$2,500 fee was paid and earned in 1932 for preliminary work and is not a part of the fee resulting from the contract (although the employment contract refers to \$30,000 including \$2,500 already paid).

(b) The \$27,500 contract payment of Oct. 15, 1932 was not an earned fee until the completion of the case as the costs deductible therefrom were not and could not have been ascertained even approximately until then.

(8) The question is also raised as to the status of transfers to general account from the trust fund in 1932-3-6 aggregating \$5,500, which were taken by



(Testimony of Edgar P. Lyons.)

the partners as fees earned and returned by them as such. As the partners could [122] not have known the outcome of the litigation, or the costs of possible adverse decisions, new trials, or appeals, the allocations were in fact borrowings by Hanna and Morton general account from trust funds.

(9) Taxpayer believes that his return should be computed under the provisions of Section 107, as fee allocations of \$5,500 are less than 5% of the net fee, and it is so returned, but subject to ultimate determination by the Commissioner as to the correctness of the method employed in determining taxable income. [123]

Thereupon the Income Tax Return of Daisy May Hanna for 1940 was received in evidence as Petitioner's Exhibit 14. Said Exhibit 14, so far as material, contains the following data:

"INCOME

2. Dividends .....	\$ 262.50
6. Income from partnerships, etc.	
Per Schedule .....	11,992.12
8. Rents and royalties .....	275.11
10. (b) Net long-term gain (or loss) from sale or exchange of capital as- sets .....	Loss 2,040.01
12. Total Income in Items 1 to 11.....	\$10,489.72

DEDUCTIONS

13. Contributions paid .....	417.50
14. Interest .....	622.15
15. Taxes .....	955.66
18. Other deductions authorized by law .....	1,104.99
19. Total Deductions in Items 13 to 18 .....	3,100.30
20. Net Income .....	\$ 7,389.42"

(Testimony of Edgar P. Lyons.)

This Exhibit also contains a memorandum identical with that appended to Exhibit 13, and above set forth.

The witness proceeded with his testimony, as follows: [124]

I made up the income tax returns for Mr. and Mrs. Hanna for 1940. I made it up from the books and accounts of Mr. and Mrs. Hanna and the partnership of Hanna and Morton. I prepared the schedule entitled, "Computation of Additional Tax by Applying Section 107 to Lazard Fee."

That schedule was prepared by examining Mr. Hanna's and Mrs. Hanna's copies of their Federal Income Tax Returns for the years 1933 to 1939, inclusive, and in conjunction therewith examining the letters from the internal revenue agent with respect to those years which have been examined, and the fact that the taxable income changed as a result of that examination.

At this point the following comments were made by Counsel:

"Mr. Mackay: I would like to state for the purpose of the record that we have all the revenue agent's reports for Mr. and Mrs. Hanna that were made during these years, and that they are in court.

Mr. Crouter: If your Honor please, at this stage I arise chiefly to make inquiry as to the line of examination. If it is to establish a foundation for recomputations if and when any opinion is ever rendered in favor of the Petitioners, why this would seem to me that any matter of mere computation

(Testimony of Edgar P. Lyons.)

from prior returns based upon prior acts under [125] Section 107 could be worked out under Rule 50, and the Respondent, of course, will be happy to cooperate in connection with the making of any recomputation if and when that occasion ever arises.

That, as far as I see, there would be no necessity of putting in evidence anything that would normally be worked out under Rule 50.

I just make that observation at this time because I don't know what he has in mind."

Then followed a discussion between Counsel and the Court, which concluded as follows:

"Mr. Mackay: Couldn't we do this, if your Honor please: I fully appreciate—and I don't think there will be any danger—couldn't we leave it this way: If it becomes necessary after the case is decided to take any further evidence in respect to computation, that that could be done?"

The Court: It certainly would have to be done because if we find we have got an open end here when we come to the matter of recomputation, that requires testimony on the merits of the case, aside from the recomputation feature, why we would have to open it up.

If we decide this case, for instance, in [126] accordance with the taxpayers' contention that 107 applies, then we find that we can't close the thing up because we haven't enough in the record as a basis for the computation, then we would certainly have to hold another session and admit such addi-

(Testimony of Edgar P. Lyons.)

tional evidence as will be necessary to complete the job.

Mr. Mackay: I am satisfied with that, your Honor."

The witness proceeded to testify as follows:

I did some work in 1932 for Hanna and Morton in connection with the examination of their income tax returns. I don't think there was any conference on Mr. and Mrs. Hanna's personal returns. There was a conference on the partnership return.

I wrote up for the agent when he was examining the 1932 Hanna and Morton tax returns from June to December, 1932, all the income and expense items and summarized them in such a way that he could check their tax return; and in that connection it was shown him in a conference which we had over my working papers that the \$27,500 was not included in income, but was set up in this trust.

#### Cross-Examination

I have the summaries that I showed to the agent [127] on that occasion here in the files. The agent was Mr. Kirkpatrick. I understand from the conversation I had with you over the telephone that he is deceased. This page is a detailed summary of the receipts. From June on, 1932, which is the date of the Hanna and Morton partnership. The item you referred to came in October, and it is shown here as a deposit in the Bank of America on the 15th day, and is credited to the column marked "Trusts." That is my handwriting. I have that column headed

(Testimony of Edgar P. Lyons.)

"Trusts" because the daily financial statements from which I wrote this record indicate that it should have been charged or credited to "Trusts," and the cards, the control cards for all the trusts showed it as an entry in the trust card. My working papers showed it at the end of the year as a trust with a balance of \$23,155.02. \$3,500 was included as partnership income and an additional \$2,000, as shown by Exhibit 12, was treated on the record and reported as income, one amount of \$1,000 in 1933 and \$1,000 in 1936. I think probably 1934 was the first year when I prepared the returns.

I did not have any discussions with Mr. Lang regarding any of these affairs at any time. I did not go to any source except the record in connection with the labeling of that item, "Trust, \$27,500.00." I took my summaries from the records as they were presented to me.

I recall having a conference on Mr. Hanna's [128] 1940 income tax return at the agent's office. I recall a conference first with Mr. Fraider. There was a protest at which Mr. Hanna and I attended, and I think Mr. W. E. Wells was the conferee, but I don't remember. We were discussing the merits of this 1940 return and the contention which is under consideration here.

I don't remember conferring with Mr. Wells on it. It seems to me it was Mr. Hawkins we conferred with. I know Mr. Wells and I knew him in 1940. I do not remember conferring with Mr. Wells



(Testimony of Edgar P. Lyons.)

about the matter. I appear before the agents in their office in connection with a number of cases over a period of years. In connection with this particular case of Mr. Hanna, I did not make any notes or memoranda regarding any conference before Mr. Wells.

With respect to the last item shown on Exhibit 12, \$7,769.55, that was included in the 1940 partnership income along with the \$114,000 for the year 1940. The schedule attached to Exhibit G, which shows only \$115,287 was made up of the \$7,700 to which you referred. plus the \$114,000 which has been referred to, and from which, however, has been deducted the \$6,500 also referred to as having been paid to Brown and Dudley. That makes the exact amount. That sum is included in here.

The gross amount received, including the seventy-seven hundred odd dollars and the \$111,000, which was testified [129] about in court, would constitute all of the moneys received from the Lazard litigation in 1940, according to the computations I have made, remembering that we deducted from that total the sums paid to those other lawyers.

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Thereupon Counsel for the Respondent called

EDGAR P. LYONS

as a witness for Respondent; and under examination he testified as follows:

(Testimony of Edgar P. Lyons.)

Direct Examination

I know what the sums were received by the firm in connection with the Market Street litigation and the Blum case. They are on those cards, the trust cards. I can tell the total amounts received by Hanna and Morton from any of the clients represented in those cases if I refer to other information. I would have to examine those cards to determine whether the information is available in court. I could give you the information if I had the cards. They are available.

Thereupon the Petitioner rested.

Mr. Lyons, on Direct examination on behalf of the Respondent, proceeded to testify as follows:

I have summaries from the records of Hanna and Morton showing total amounts received by the firm in connection with the so-called Market Street litigation. The Lazard trust cards show on February 8, 1938 they received from the Anglo-California National Bank \$19,032.19 from the [130] Market Street case. The card shows that was received from the Bank, which was one of the defendants. That is the only sum shown by the records as having been received in the Market Street case. On February 8, 1938, a check was drawn to Courtney Moore, attorney in San Francisco, for \$3,100 and charged to that account, and on the same date a check for \$9,516.10 was drawn to Lazard Frere. On the same date a transfer of \$6,000, approximately the balance, was made as a transfer to legal fees received from the trust.

(Testimony of Edgar P. Lyons.)

A total amount of \$19,000 was received by Hanna and Morton and deposited. Lazard Frere was the name of the client. Mr. Moore is an attorney in San Francisco. In connection with this Market Street case, in the years 1937 and 1938, if I remember correctly, there were some \$400 or \$500 worth of expenses in this case marked on the card. That is where the difference comes in.

A card which includes the transactions in the Portland case indicates that on October 13, 1941 there was received and deposited \$43,429.79. And the card shows under date of October 11, 1941, payment made to Courtney L. Moore for \$20,000 and a transfer out of the trust for \$23,429.79 to client's income card. That shows the complete distribution of the forty-three thousand odd dollars as far as the records go.

The Lazard trust card indicates the receipt on [131] June 5, 1940 of \$5,000 in connection with a case known as the bankruptcy case. On the same date a check was written to Courtney L. Moore, the San Francisco attorney, for \$2,500, and the balance, \$2,500, was then transferred to income in 1940.

There are no other records that I know of, or any amounts which were received in connection with any of these Lazard litigations. I am familiar with all their records at this time.

Approved.

(Signed) J. P. WENCHEL. CAR.

[Endorsed]: Filed T.C.U.S. May 19, 1945. [132]

United States Circuit Court of Appeals  
for the Ninth Circuit

No. 740

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S STATEMENT OF POINTS TO  
BE RELIED ON AND DESIGNATION OF  
PARTS OF THE RECORD TO BE  
PRINTED

Comes now Daisy May Hanna, the petitioner for review in the above-entitled cause, and states that the points on which she intends to rely in this case are as follows:

1. The Tax Court of the United States erred in finding as a fact or deciding as a matter of law that the withdrawals from the \$27,500 trust fund mentioned in the Findings, amounting to \$5,500, constituted payment of a part of the fee for the services rendered in the employment mentioned in the Findings, to Hanna and Morton when and as received by Hanna and Morton;

2. The Tax Court of the United States erred in finding as a fact or deciding as a matter of law that the withdrawal of accrued interest on the said trust fund, amounting to \$1,168.86, constituted payment of a part of the fee for the services rendered in the

said employment to Hanna and Morton when and as received by Hanna and Morton; and [133]

3. The Tax Court of the United States erred in determining that less than 95% of the fee of Hanna and Morton for services under the employment above mentioned was received in the calendar year 1940.

Petitioner hereby designates the entire record, as certified to the Clerk of the above-entitled Court, as necessary to be printed for the consideration of the points set forth above.

A. CALDER MACKAY and  
ADAM Y. BENNION  
A. CALDER MACKAY

By ADAM Y. BENNION  
Attorneys for Petitioner

Service admitted 5/18/45.

(Signed) J. P. WENCHEL. CAR.

[Endorsed]: Filed T.C.U.S. May 19, 1945. [134]

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[Title of Circuit Court of Appeals and Cause.]

PETITIONER'S DESIGNATION OF CON-  
TENTS OF RECORD ON REVIEW

Petitioner hereby designates for inclusion in the record on review in the above-entitled proceeding, the following:

The complete record of all the proceedings and evidence taken before The Tax Court of the United States and all matters required by Subdivision (g)



of Rule 75 of the Federal Rules of Civil Procedure; excepting exhibits filed as evidence, but including the statement of evidence in this cause heretofore prepared, served and filed.

Dated: May 4, 1945.

A. CALDER MACKAY and

ADAM Y. BENNION

A. CALDER MACKAY

By ADAM Y. BENNION

Attorneys for Petitioner

Service admitted 5/18/45.

(Signed) J. P. WENCHEL. CAR

[Endorsed]: Filed May 19, 1945. [135]

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[Title of Tax Court and Cause.]

### CERTIFICATE

I, B. D. GAMBLE, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 135, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 4th day of June, 1945.

[Seal]

B. D. GAMBLE

Clerk, The Tax Court of the  
United States.

[Endorsed]: No. 11071. United States Circuit Court of Appeals for the Ninth Circuit. Daisy May Hanna, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcrip of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed June 11, 1945.

. PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.

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United States Circuit Court of Appeals  
for the Ninth Circuit

No. 740

DAISY MAY HANNA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

ORDER

For cause appearing of record, it is hereby

Ordered: That the time for transmission and delivery of the record on petition for review of the above entitled proceeding in the United States

Circuit Court of Appeals for the Ninth Circuit be  
and it is hereby extended to June 22, 1945.

FRANCIS A. GARRECHT,  
Judge

Dated May 18, 1945, San Francisco, California.

[Endorsed]: Filed May 18, 1945. Paul P.  
O'Brien, Clerk.

A true copy.

Attest: May 18, 1945.

[Seal] (s) PAUL P. O'BRIEN  
Clerk.

Now: June 5, 1945, the foregoing order is certified  
from the record as a true copy.

[Seal] B. D. GAMBLE  
Clerk.

[Endorsed]: Filed T.C.U.S. May 23, 1945.